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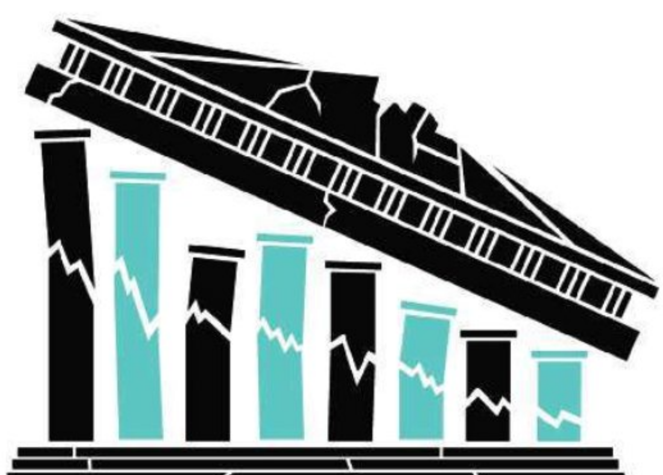
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June 28 — July 4, 2010 | **businessweek.com**

Bloomberg Businessweek

The Greek people are angry. While young anarchists wielding Molotov cocktails get most of the attention, far greater numbers stew in tiny apartments, livid at their leaders for capitulating to the markets and saddling them with a life-changing burden. Here's the thing: Their leaders are right. And in misery lies hope



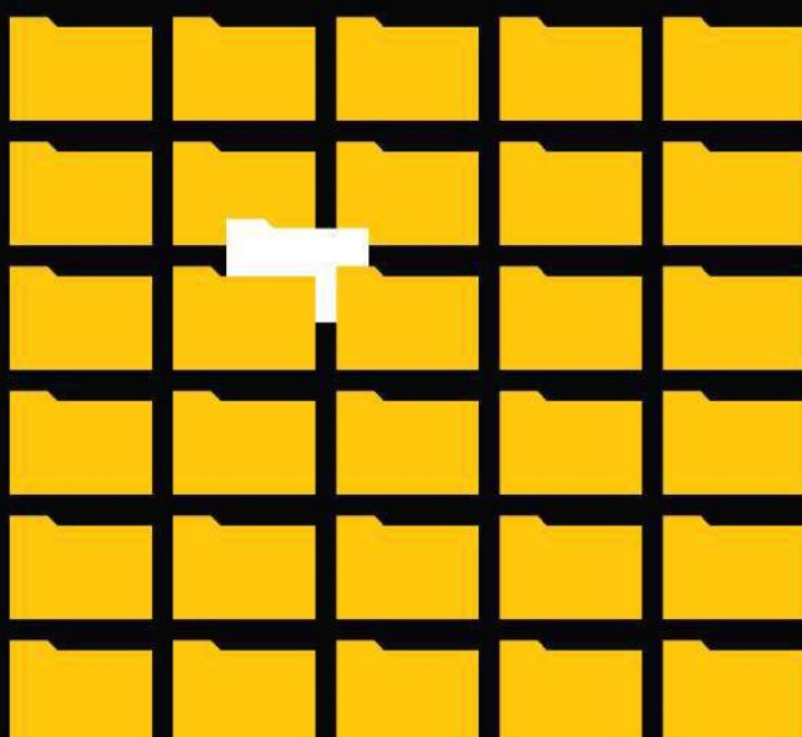
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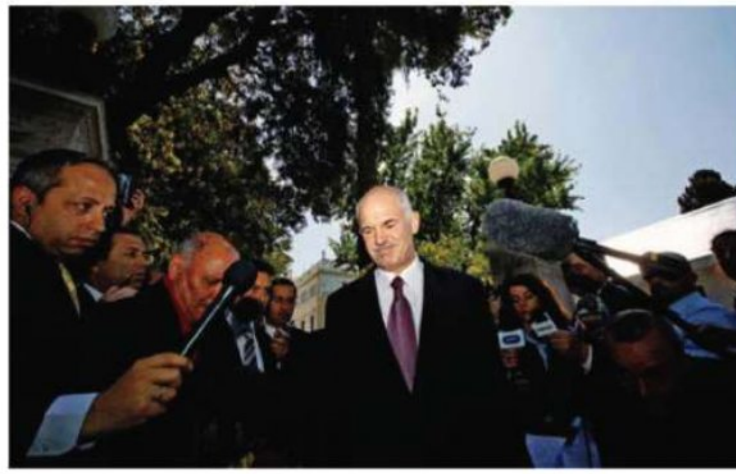
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Corrections & Clarifications

● "Like Candy from a Baby" (Features, June 21) erroneously identified Richard Kimball as a manager at P.S. Capital Holdings. He was a manager at its successor, the Millennium Technology Venture Fund. The article also said the hit taken by Jacob "Jacob the Jeweler" Arabo on two movie ventures recommended by Kenneth Starr was $1.4 million out of a total of $13 million lost; the figures should have been $2.7 million and $13.9 million. ● "A Problem Like LeBron" (Opening Remarks, June 21) failed to note that the immediate reason David Boies left the law firm Cravath, Swaine & Moore in 1997 was a disagreement over a conflict-of-interest decision—not compensation. The story also should have said that James "can't" receive more than 30 percent of a team's salary cap.

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Opening Remarks

Five Ways Forward With China

Washington needs much more than an exchange-rate "head fake" from Beijing to correct the glaring trade imbalance.
By Peter Coy

For one day–Monday, June 21–America's economic relations with China seemed to be on the right track. The Chinese currency jumped in value following a weekend announcement by the People's Bank of China that it would increase the flexibility of the exchange rate. A stronger yuan raised hopes for U.S. exporters trying to penetrate the booming Chinese market, and gave domestic American producers competing with cheap Chinese imports a much-needed boost at home. Treasury Secretary Timothy Geithner said China's move would "make a positive contribution to strong and balanced global growth."

On June 22, the relationship was back to normal. The yuan gave up half of the previous session's gains as traders concluded that the central bank's commitment to flexibility did not imply a large and sudden increase in the yuan's value. U.S. labor leaders and some members of Congress argued that China's announcement was timed to deflect criticism by the U.S. and other nations at the Group of 20 summit in Toronto on June 26 and 27. "It looks to me like it was kind of a head fake. They're not contemplating anything like what we need," says Clyde Prestowitz, president of the Economic Strategy Institute, a Washington consulting firm.

The episode conveys an important lesson about the prolonged stress in U.S.-China economic relations: There's no easy solution that will suddenly make the superpowers synergistic. Americans blame China for not letting the yuan rise significantly, for not enforcing U.S. patents, for not putting American-made products on an equal footing with Chinese ones. China blames the U.S. for not putting its own fiscal house in order. Beijing fears that any rapid policy change would spur unemployment and social instability. As China grows, U.S. influence shrinks. "What we're finding is that the United States is bumping up against the limits of the tools that it's had available," says Evan A. Feigenbaum, a Deputy Assistant Secretary of State in the George W. Bush Administration who heads the Asia practice at the Eurasia Group, a New York-based consultancy.

The U.S. can't just ignore China. It's the fastest-growing major economy in the world at around 10 percent annually since the mid-'90s. The U.S.-China Business Council points out that exports of American goods to China have risen 330 percent since 2000, vs. an increase of just 29 percent to the rest of the planet. And cheap imports from China have held down the U.S. cost of living.

What, then, can the U.S. do to get the most out of its economic links with China? Here are a few of the options:

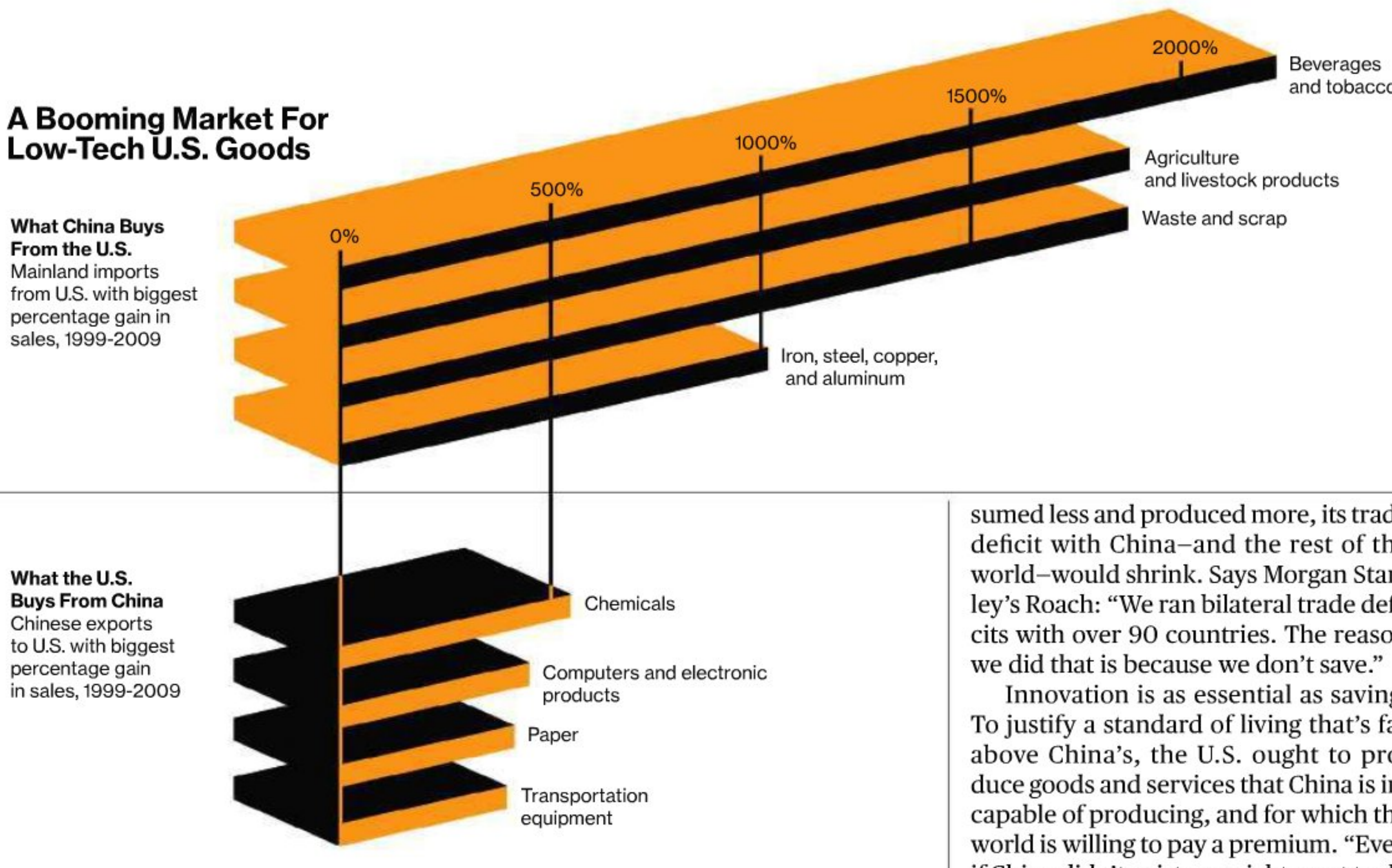
1 Block China: In a March *New York Times* column, Paul Krugman, the Nobel laureate Princeton economist, advocated for the U.S. to impose a temporary 25 percent tariff on imports from China until the country meaningfully raises the value of the yuan. Krugman elaborated on his argument in an interview with *Bloomberg Businessweek*, saying that by keeping its currency undervalued in a period of sluggish global demand, China is, in effect, exporting its unemployment problem to America. "It's a world where mercantilism actually works and hurts the other guy," Krugman says. Even if China refuses to back down on the currency clash, Krugman argues that the U.S. would come out ahead because the tariffs would create more jobs at home without causing inflation.

The problem with unilaterally imposed tariffs is that China would undoubtedly protest them at the World Trade Organization–and might well win sanctions, forcing the U.S. into an embarrassing retreat or, worse, deliberate defiance of the global trading rules that it helped invent, says Morgan Stanley Asia Chairman Stephen Roach. "You don't suspend the rules of free trade during recessions."

2 Declare an Emergency: Ian Fletcher, an adjunct fellow of the 77-year-old U.S. Business & Industry Council and author of the bluntly named *Free Trade Doesn't Work*, says Obama should make like President Richard Nixon circa 1971 and declare a balance-of-payments crisis, meaning that the U.S. can't cover the cost of its imports. That, he says, would entitle Washington to impose tariffs on imports from all countries. "People have to be willing to get some serious blood on the carpet," says Fletcher. Though less discriminatory than China-only tariffs, Fletcher's solution would undermine America's claim to leadership of the global trading system.

3 Use the WTO: China reformed its Communist economy to qualify for the World Trade Organization, but has backslid since gaining membership

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DATA: INTERNATIONAL TRADE ADMINISTRATION

in 2001. The "indigenous innovation" drive that accelerated last year—an attempt to become technologically self-sufficient by learning from the West—is the latest manifestation of a Chinese tendency that goes back to the Self-Strengthening Movement of the Qing Dynasty in the late 19th century. The U.S. could use the WTO more aggressively to stop China from favoring domestic products over imports, says Robert Cassidy, who was an assistant U.S. trade representative responsible for China under President Bill Clinton. China takes WTO compliance seriously. The problem: China has learned to play the WTO game. "China knows better today how to pursue its industrial policies with tools that won't trigger a WTO case," says Ted Dean, vice-chairman of the American Chamber of Commerce in China.

4 Talk, Talk, Talk: The more points of contact there are between the U.S. and China, the better the chances of progress. A program known as the U.S.-China Strategic & Economic Dialogue, begun under President George W. Bush, widened the conversation between the U.S. and China beyond trade issues to include currency and economic concerns. The periodic U.S.-China Investment Forum, also begun under Bush, brings Americans into contact with the central planners of China's National Development & Reform Commission. Chinese importers, consumers, and even techies often have interests that align with those of the U.S.

Opposition last year from Chinese Internet enthusiasts forced the government to back down from a plan to put intrusive filters on all personal computers sold in the country. "We need to be able to find ways to work with constituencies within China that agree with us to attack those that don't," says Charles Freeman, an assistant U.S. trade representative in the Bush Administration who is now with the Center for Strategic & International Studies think tank in Washington. One obvious potential snag, however, is that China is famously sensitive to any perceived foreign meddling.

5 Get America's House in Order: China isn't forcing Americans to live beyond their means. If the U.S. consumed less and produced more, its trade deficit with China—and the rest of the world—would shrink. Says Morgan Stanley's Roach: "We ran bilateral trade deficits with over 90 countries. The reason we did that is because we don't save."

Innovation is as essential as saving. To justify a standard of living that's far above China's, the U.S. ought to produce goods and services that China is incapable of producing, and for which the world is willing to pay a premium. "Even if China didn't exist we might want to do more R&D here," says Douglas Irwin, an economics professor at Dartmouth College who advocates free trade.

Putting things right at home is more easily said than done. Even as China proclaims that boosting consumption is a national priority, recognizing the need to rebalance its economy, it's fighting the market forces that would reduce savings rates in China and raise savings in the U.S. That's the whole point of buying $900 billion of U.S. Treasuries to keep the dollar up and the yuan down. As for technical excellence, U.S.-based multinationals aren't making it easy for American workers to excel: They are building some of their most advanced facilities in China and training Chinese workers to operate them, Prestowitz notes.

No approach to China is foolproof. "If we think we're going to find a silver bullet—we ain't got one," says Myron Brilliant, senior vice-president for international affairs at the U.S. Chamber of Commerce. The only option is to make the best of a difficult situation, remembering that both sides have a lot to lose. B

—With Dexter Roberts in Beijing

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Prefabricated houses in a new development on the outskirts of St. Petersburg

Building the New Russian Dream, One Home at a Time

▶ Russia wants to move its citizens from apartment blocks to suburban housing developments

▶ "People who have their own homes, driveways, and careers are fundamentally different"

The Soviet Union collapsed nearly two decades ago, yet in Moscow the habit of central planning dies hard. Russian President Dmitry Medvedev, in a speech two years ago, bemoaned the fact that 77 percent of the country's 142 million citizens live "cooped up" in apartment blocks. Now his government has a plan to liberate them, amassing almost 2.5 million acres to seed the land with single-family homes. "Call it the Russian dream," says Alexander A. Braverman, who runs the Federal Fund for the Promotion of Housing Construction Development, which Medvedev (right) created. "I think we can make this dream come true."

As the U.S. struggles to recover from the housing bust, some economists are reconsidering the soundness of policies that promote homeownership. Russia's leaders aren't worried. After visiting a newly completed development of prefabricated houses on the outskirts of St. Petersburg in November, Prime Minister Vladimir Putin said he hoped homeownership will inspire Russians "to have more babies."

Developers, including **Mospromstroy** and **National Housing**, are lining up to profit from the coming boom in housing construction. At least 14 million square meters of housing are expected be under construction by next year on land owned by the federal fund. That will rise to 20 million square meters in 2012, or about 30 percent of all residential construction in Russia. "We think that people who have their own homes, driveways, and careers are fundamentally different than those who don't have these things," says Braverman. "The person who has something to defend is a different kind of person."



To convert Russians to the

FROM TOP: ALEXANDER BELENKY; DAVID W. CERNY/REUTERS

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joys of property ownership, the fund plans a marketing blitz, including billboards and TV and print advertising. "In the U.S. in the 1960s, the demand for homes came first and the government provided the rest," says Nadezhda Kosareva, president of the Institute of Urban Economics, a research group in Moscow. "In Russia the government is trying to push the idea from above."

One obstacle to realizing Medvedev's goal of transforming Russians from apartment-dwellers into homeowners is an underdeveloped home-loan market. Mortgages are somewhat of a novelty, with the total portfolio of outstanding residential loans totaling just $32.5 billion, according to central bank data. Interest rates averaged 13.8 percent in the first four months of the year. To spur borrowing, the government plans to channel $8 billion through the federal mortgage agency, which offers subsidized loans at 11 percent interest. Nuri Katz, chief executive officer of **Century 21 Russia**, doubts this will be enough: "It's a simple real estate rule. Without the widespread availability of affordable mortgages, there will be no widespread availability of affordable housing."

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PERCENT

Decline in new home sales in May. The 300,000 starts on housing construction were the lowest since the Census Bureau began keeping records in 1963. The drop follows the April expiration of a special tax credit for home buyers.

DATA: COMMERCE DEPT.

Braverman's fund has auctioned off the rights to develop 29 parcels of land nationwide and plans to bid out 46 more this year. Officials insist that homes built under the program will be affordable—costing around 30,000 rubles (less than $1,000) per square meter. By comparison, residential prices in Moscow's secondary market averaged $4,406 per square meter in May, according to a local index.

To attract developers, the government is guaranteeing it will buy up to 35 percent of the homes built. "We strive to reduce risks on our properties," says Braverman, "so investors are interested." Mospromstroy, which has renovated many government buildings in the capital, won bidding on around 90 acres near Moscow in February, offering to pay $44 million for a five-year lease to develop the property. Braverman says he is "absolutely open" to allowing foreign investors to take part in the auctions, but none have so far.

Some prospective Russian developers think the government should foot part of the construction bill. Alexander Lebedev, whose National Housing can churn out 20,000 prefabricated housing units a year, says he wants to make his product affordable but "can't do it alone." On this point, Braverman stands firm: "Our basic position is that we don't build."

—*Anastasia Ustinova*

The bottom line *The government has launched a program to move Russians out of apartments and into homes. Financing may prove to be an obstacle.*

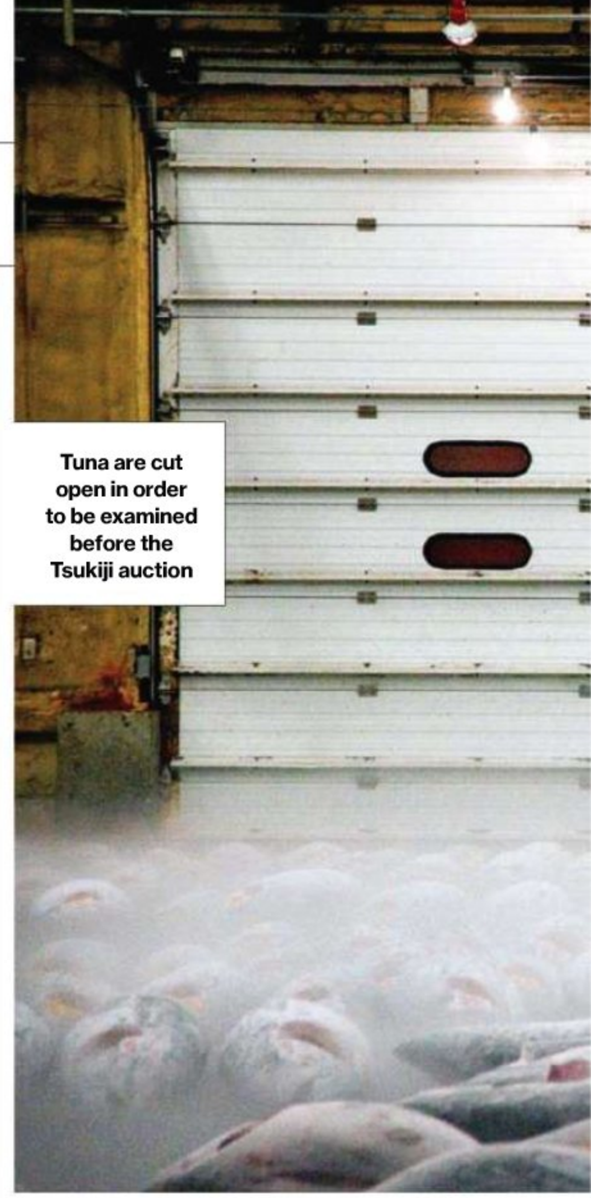
Food Chain

Bluefin Tuna: Another Possible Gulf Casualty

▶ A major spawning ground for the fish overlaps with the oil spill

▶ "The oil plus the dispersants are likely to have a huge effect"

Tokyo's Tsukiji fish market is a long way from the oil-drenched waters of the Gulf of Mexico. Starting at 4 a.m. every day, agents from Japanese trading companies bid for bluefin tuna and other fish from around the world that lie side by side on the floor of a cavernous warehouse. Bluefin is a mainstay of any sushi restaurant in Tokyo, and the giant fish—sometimes weighing more than 500 pounds—is the king of Tsukiji. BP's spill is billowing near one of two spawning grounds for the Atlantic variety of bluefin (the other is in the Mediterranean). For now, fishmongers in Tsukiji say they're not worried about the effect the **BP** disaster will have on the bluefin population. "If there's an impact," says one trader for local wholesaler **Umino** who won't give his full name, "we won't see it for a few years."



Tuna are cut open in order to be examined before the Tsukiji auction

JEREMIE SOUTEYRAT

Go to the U.S., though, and you'll find plenty of scientists, state officials, and fishermen wondering already about the disaster's impact on the bluefin. Japan last year consumed about 80 percent of the world's bluefin catch, or 52,000 tons, according to the Japanese Ministry of Agriculture, Forestry & Fisheries. A large chunk of that comes from the Atlantic. The chemicals BP is using to contain the spill could damage the bluefin larvae produced by adults that spawned in the Gulf. "The oil plus the dispersants are likely to have a huge effect," says Bill Fox, managing director for fisheries at the World Wildlife Fund. For the Atlantic

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bluefin, "this is a real blow."

Scientists from several institutions, including the National Oceanic & Atmospheric Administration, are trying to figure how big the blow really is. Bluefin tuna live for up to 40 years, and in that time many repeat the same cycle endlessly: spawn in the Gulf or the Mediterranean, then head to the teeming waters of the North Atlantic to feed. Spawning in the Gulf takes place from March to June, and the spawning ground overlaps with the oil spill. Bluefin need clean ocean water to spawn—adults spawn at the surface, so they may have gotten coated with oil while spawning this year.

No one is sure exactly what happened this year when the Gulf spawning season started. If there is an effect, "we'll see [it] in about three to four years," says Greg Stunz, marine scientist at the Harte Research Institute for the Gulf of Mexico in Texas. That's when the bluefin tuna born this year reach adult size. A weakened, underpopulated generation of bluefin would show something serious happened. Some fishermen, though, say enough of the spawning occurred before the Apr. 20 spill to minimize the damage.

Others in the industry think it will prove impossible to separate the spill's impact from the general collapse of the bluefin population. Stocks of fish that spawn in the Gulf are at just 10 to 20 percent of their 1960s levels, Fox says. In the Mediterranean, the spawning ground that accounts for more than half the annual Atlantic catch, severe overfishing has led to a similar decline in supply. Environmentalists clashed with fishermen off the coast of Malta in June, and the European Commission called a halt to fishing early after the quota was used up. The dramatic drop in the bluefin population has prompted international regulators to make sharp cuts in the permissible catch. In March, though, Japan successfully fought a proposed Atlantic ban by the U.S. and the EU. The average price for bluefin tuna in Tsukiji, meanwhile, has risen 26 percent, to $37 a kilo, since 2005. Last winter one hefty specimen fetched $177,000 at Tsukiji.

The problems in the Atlantic—and similar declines in the Pacific—are leading the bluefin industry in Australia to sense an opening for their bluefin, long considered an inferior cousin by Japanese consumers. The Australians last year launched a rebranding campaign in Japan, changing the name of the fish from *indo maguro*, or Indian bluefin, to *minami sodachi maguro*, or beautiful wave-bred bluefin. "The basic aim was to get more Japanese to taste southern bluefin and recognize that there is no real difference," says Brian Jeffriess, chief executive officer of the Australian Southern Bluefin Tuna Industry Assn. According to Jeffriess, the price per kilo of Australian-caught bluefin has gone up to $19, a 40 percent increase since March. Japanese trading companies such as **Mitsubishi** that buy frozen bluefin are expected to agree to an even higher price for Australian bluefin soon. The BP disaster "will inevitably have a big effect at a time when there's already uncertainty about the sustainability of the [Atlantic] stock," says Jeffriess.

The bluefin are hardy creatures, and there's still reason to hope they can withstand the latest setbacks. "Once they get to full size, there's nothing that can catch them other than humans," says the WWF's Fox. "But every year we move into more uncharted territory."
—*Bruce Einhorn and Stuart Biggs, with Caroline Winter*

The bottom line *The oil spill in the Gulf may hit a bluefin tuna population already threatened by years of overfishing.*

Recovery

Europe Looks Better The Closer You Get

▸ **Businesses don't see much fallout from the turmoil in sovereign debt**

▸ **"The fear of a double-dip recession is going to evaporate"**

Europe is a mess. That's been the message trumpeted in headlines for months. Ajay Banga doesn't see it that way. "It's almost like a tale of two Europes," says the incoming chief executive officer at Purchase (N.Y.)-based **MasterCard**. "We read about debt crises and sovereign debt issues. I don't see any real impact yet," he says, citing data that show European consumers and executives are still using their cards to spend on travel and entertainment.

The optimism of executives like Banga suggests the 16-nation euro

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Global Economics



Sales of Pepsico's Lifewater come back page 15▶

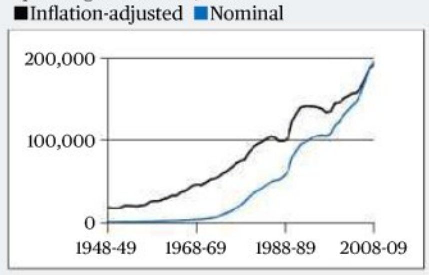
Fiscal Crises

Britain's Scary Budget

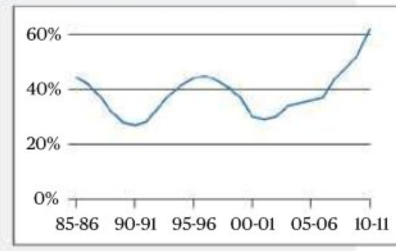
U.K. Chancellor of the Exchequer George Osborne revealed his budget—and it was as painful as promised. The goal is to slash until 2015, when the budget deficit is supposed to be 50 percent smaller than forecast by the previous government. The tightening comes to about $60 billion a year by 2015.

The Problem:

An ever-growing welfare state ...
Spending on benefits, in £m
■Inflation-adjusted ■Nominal

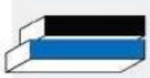


...and mounting national debt
British national debt as a share of GDP



The Proposed Solution:

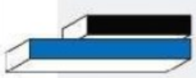
Higher taxes for many:



Value-added tax:
Present: 17.5%
Proposed: 20%



Tax on bank assets:
Present: 0%
Proposed: 0.07%



Capital-gains tax:
Present: 18%
Proposed: 28%

Lower taxes for some:



Corporate income tax:
Present: 28%
Proposed: 24%



New exemptions:
880,000 low earners will be exempt from income taxes

Big cuts in government:



Welfare budget:
Cut of $16.5 billion



Average cut in government costs:
All agencies outside National Health and overseas aid must reduce spending by a quarter before 2015

DATA: BLOOMBERG NEWS, BRITISH GOVERNMENT, OFFICE OF NATIONAL STATISTICS, INSTITUTE OF FISCAL STUDIES

economy may avoid sliding back into recession. Many economists have been pessimistic about Europe as its governments struggle to contain record deficits. Yet European companies have already cut costs and wooed new customers from abroad. They are getting an export boost from an 18 percent drop in the euro's value against the dollar. **Volkswagen**, Europe's top carmaker, said on June 16 that the euro's decline is helping sales abroad and that operating profit and deliveries may rise "significantly." The euro's fall may benefit sales of the Golf compact, VW's global bestseller, which is made in its Wolfsburg (Germany) plant. Spurred by demand for goods such as car engines and steel, European industrial production rose 0.8 percent in April, better than the 0.5 percent forecast.

Europe's good fortune is helping U.S. companies operating on the Continent. David J. Bronczek, CEO of FedEx Express, says **FedEx** itself, the world's biggest air-cargo carrier, has "seen solid growth in Europe." Ronald J. Pasek, chief financial officer at **Altera**, the San Jose-based maker of programmable semiconductors, says Europe's debt turmoil doesn't "fundamentally affect what we're seeing right now, which is good news." Altera's chips are used by an array of manufacturers, so its business is a reliable barometer of industrial production.

These signs of life are helping to stabilize the shaky bond markets. Spain saw strong demand for a 30-year bond on Mar. 17, easing concern that the Spanish government will struggle to finance its debt. "As we get more good than bad news, the fear of a double-dip recession is going to evaporate," says Erik Nielsen, chief European economist at **Goldman Sachs** in London. His forecast of 1.4 percent euro-area growth this year is stronger than the 1.1 percent median prediction of economists surveyed by Bloomberg News. "People are still bearish," adds Nielsen, "but will come around."

—*Gabi Thesing and Anthony Feld*

The bottom line *Economists may be overdoing the gloom on Europe. Businesses report good results in the region. The drooping euro could help.*

Labor

More Car Jobs Shift to Mexico



▶ U.S. production may decline over the next decade, despite the bailout

▶ Offshoring by rescued automakers is "reprehensible," says Dingell

The Obama Administration spent more than $80 billion last year to prop up **General Motors** and **Chrysler** in a controversial effort to save millions of American manufacturing jobs. Both car companies have since stabilized, and business is also looking up at **Ford Motor**. Yet as

FROM LEFT: SUSANA GONZALEZ/BLOOMBERG; JOSHUA ROBERTS/BLOOMBERG; ANDREW HARRER/BLOOMBERG

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Quoted

"It's an opportune time for Canada to preside over the G20 because [our] performance is something a lot of countries want to emulate. We have a robust role for government, [yet] it is fundamentally a private-sector economy. To the extent we have generous social policies, for the most part those are well funded."
—Stephen Harper, Prime Minister of Canada



they map out their investment plans in the year ahead, the U.S. auto companies will likely put most of their new jobs and plant capacity in Mexico, not the U.S., auto analysts predict.

Chrysler announced in February that it's spending $550 million to retool its factory in Toluca to assemble the subcompact Fiat 500 model. Last month, Ford reopened an assembly plant in Cuautitlán to build Fiesta compacts for the 2011 model year. The factory will generate 2,000 jobs and is part of $3 billion in investments in Mexico announced since 2008. In the U.S., Ford has closed four assembly plants since 2006 and plans to close four more facilities by the end of 2011.

Mexico's gains will come at the expense of workers in the U.S. and Canada, says Dennis DesRosiers, president of DesRosiers Automotive Consultants in Richmond Hill, Ontario. Mexico's share of North American auto production will rise to 19 percent over the next decade, from an average of 12 percent from 2000 to 2009, according to DesRosiers. Over the same period the U.S. will lose 7 percentage points, to 65 percent of the market, and Canada's share will hold at 16 percent. "There is going to be more capacity put into North America–and Mexico is going to get more than its fair share," he says.

Moves to Mexico may speed up as Chrysler and GM pay back government bailout money and the political scrutiny they face eases, says Michael Robinet, vice-president of global forecasting for CSM Worldwide in Northville, Mich. The reason isn't hard to fathom. GM workers in Mexico earn wages and benefits of 340 pesos a day ($26.40) on average, or less than $4 an hour, says Tereso Medina, head of the union for GM's 5,000 workers in Saltillo, a city about 180 miles (300 kilometers) south of the Texas border, where one in four Mexican autos is produced. GM and Ford workers in the U.S. earn about $55 an hour with benefits.

Representative John Dingell (D-Mich.) believes U.S. automakers that received government assistance should work to preserve U.S. jobs. "I understand the economic argument for the offshoring of production, but I think the practice is reprehensible," Dingell noted in an e-mail. "U.S. automakers have benefitted greatly from federal largesse and should feel morally compelled to retain and create as many domestic jobs as possible."

Mexico stands to benefit from more stringent U.S. fuel-efficiency requirements because it's more profitable to make small cars where labor costs are lower, Robinet said. Ford says it continues to invest heavily in its American production capacity. Mexico was responsible for 14.2 percent of Ford's U.S.-Mexican car production last year and 16 percent in 2008, compared with 11.8 percent in 2006, according to company data. For every dollar Ford invested in Mexico during the past five years, the company spent $7 in the U.S., says James Tetreault, vice-president for North American manufacturing. Ford's two Mexican assembly plants have operated for more than 30 years, he says. "In North America, it's all about utilizing our existing footprint," Tetreault says. "It's not like we're building greenfield plants and moving production to Mexico."

GM has announced investments of $3.67 billion in Mexico since November 2007, including a new assembly plant in San Luis Potosí. The company has closed five U.S.-based assembly plants and put three more on standby since June 2005, according to Tom Wilkinson, a GM spokesman.

A significant portion of Chrysler's production of the Fiat 500 will be sold in South America, said Jodi Tinson, a spokeswoman. "Mexico is in an ideal position as a bridge between Nafta and Latin America because of the country's free-trade agreements with its neighbors to both the north and south," Tinson said in an e-mail. —*Thomas Black*

The bottom line *For Detroit automakers, the economic advantages of building cars in Mexico will likely trump pressure to keep jobs at home.*

Tom Keene's EconoChat

Tom talks with **Nariman Behravesh**, chief economist at consultants IHS Global Insight, about the chances for a strong second half.

Is the general economic prognosis wrong and we're better? Or is it wrong and we're worse?
The risks actually are fairly balanced, even though the focus has been on the bad news from Europe and concerns about the property bubble in China and all that. For the U.S., there's some upside risk. Productivity growth is strong. You could get strong growth in Asia so exports could do fairly well. We've still got a lot of stimulus in the pipeline.

If I look at your fabulous Excel spreadsheets, your gloom number on unemployment at the end of next year is 10.2 percent and your optimism number is 8.3 percent. Can we be satisfied with 8.3 percent unemployment?
Absolutely not. The problem here is we're in such a deep hole. We lost 8.5 million jobs in the last recession, which by the way is worse than the last four recessions combined.

We're nearing the end of the first half. The one consensus is this idea of slowdown in the second half. What could we get wrong that would make for a better economy?
Consumers and businesses spending more. I'm especially optimistic on the business side because companies are sitting on a mountain of cash. The ratio of corporate cash flow to GDP is the highest ever. If businesses open up their purse strings and spend on capital goods and on hiring people, you could get a much stronger recovery.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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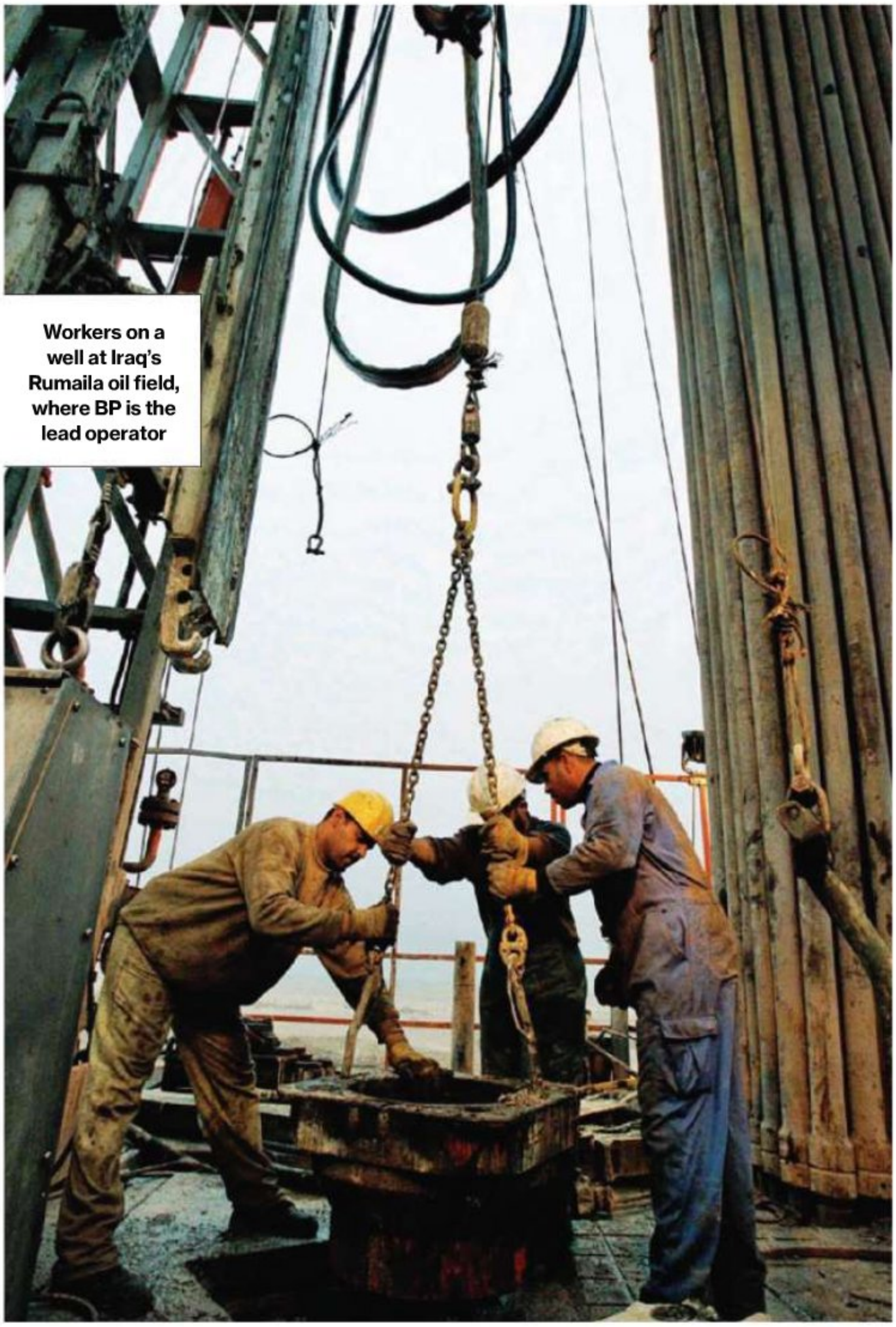
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Why the U.S. Can't Turn Its Back on BP

▶ **Oil spill aside, U.S. energy security will suffer if BP goes under or is significantly reduced in size**

▶ **A healthy BP "is in all of our interests," says President Obama**



Workers on a well at Iraq's Rumaila oil field, where BP is the lead operator

ATEF HASSAN/REUTERS

With public anger off the charts over **BP**'s role in the Gulf of Mexico oil disaster, there's not much sympathy about the financial burden the British oil company faces from future legal claims and cleanup costs. BP says it's considering asset sales to help cover the cost of a $20 billion escrow fund the White House demanded the oil major set up to handle U.S. claims. The company's survival may also be in doubt if the financial hit from the Deepwater Horizon rig explosion approaches $100 billion, as some analysts suggest is possible.

Such a scenario would destabilize U.S. energy policy at home and abroad. President Barack Obama recognized as much when he said on June 16 that "BP is a strong and viable company, and it is in all of our interests that it remain so." The company's demise would be disruptive to the American oil industry, given that BP is the largest oil and gas producer in the U.S., with about 1 million barrels per day of production. Some 7,000 of BP's 23,000 U.S. employees work in the Houston area, many in a suburban office park just off the Katy Freeway. From there the company runs its Gulf of Mexico offshore operations with a phalanx of engineers, geologists, and computer scientists. "These are highly compensated people," says J. Robinson West, chairman of Washington (D.C.)-based consultants PFC Energy.

Until the Deepwater accident, BP's Gulf activities were viewed by Washington as a big plus for U.S. energy security interests. Since the mid-1990s, the British company has been the leader in Gulf exploration, pushing into deeper water and drilling farther into the earth. Its projects were key to the 7 percent growth in production the U.S. achieved last year, reversing an 18-year decline.

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BP's skill at negotiating access to new energy resources, especially in strategically important regions, has also served U.S. interests. The company opened up Azerbaijan, a major producer in the Caspian Sea region, for oil. It has developed two oil and gas fields there, as well as the Baku-Tbilisi-Ceyhan crude oil pipeline through Turkey that came on line in 2004, and offers a counterweight to Russian dominance in the region. In 2007, BP signed an agreement with the investment arm of the Libyan government to explore for gas along an offshore tract the size of Belgium.

BP's most daring move was last year's $20 billion deal in Iraq to add almost 2 million barrels per day in production to the country's prized oil field in Rumaila. That attracted deals with other companies, greatly improving Iraq's economic prospects. "BP was bold in going in first and opening up the way for the rest of them," says Toby Dodge, an Iraq scholar at the International Institute for Strategic Studies in London.

BP is starting to identify the $10 billion or more in assets it might sell to fund the costs of the Gulf spill, says Managing Director Robert Dudley, who has taken over day-to-day oversight of the cleanup from Chief Executive Officer Tony Hayward. "We have to sharpen the portfolio to pace ourselves for what has happened in the U.S.," Dudley says. A person familiar with BP's investment plans says it may need to raise as much as $50 billion to cover costs related to the disaster. Oppenheimer oil analyst Fadel Gheit thinks BP could end up in bankruptcy if costs exceed $100 billion, a possibility if partners in the stricken well, such as **Anadarko Petroleum**, pin full responsibility on the company.

If so, BP may have to part with some prized assets, and Chinese and Russian oil companies less in sync with Washington could step in as buyers and change the geopolitics of the oil industry. "Companies will be interested in buying assets in Azerbaijan, Angola, Brazil, and potentially also Norway," says Gudmund Halle Isfeldt, an analyst at DnB Nor, Norway's largest bank.

—*Stanley Reed, with Brian Swint, David Wethe, and Torrey Clark*

The bottom line *BP controls strategically sensitive energy assets. Selling them may jeopardize U.S. energy security interests in the Middle East and Asia.*

69

PERCENT

Share of 1,400 chief financial officers surveyed who say they check in with the office at least once or twice a week while on vacation

DATA: ROBERT HALF MANAGEMENT RESOURCES

Tobacco

Altria vs. the FDA: More Than a Mild Dispute

▶ **The regulator wants the research behind the selling of Marlboro Golds**

▶ **"It is potentially perpetuating this untruth," says the U.S. tobacco czar**

Marlboro Lights are no more. From now on smokers will have to ask for "Marlboro Golds." Corporations do not change iconic brands lightly. In this case cigarette manufacturer **Altria Group** had no choice. The Food & Drug Administration, which as of last year regulates tobacco products, banned the use of the words "mild," "light," or "low tar" on packages effective on June 22. The agency says such cigarettes are just as harmful as regular ones.

Before Altria made the switch, it used the old packs to tell smokers that while the look of Marlboro Lights would change, the "cigarette stays the same." That got the FDA's attention.

The agency argues many consumers will continue to assume Marlboro Golds are safer than regular smokes and has ordered Altria to hand over market research showing why it used the tactic. "What we're concerned about is that it is potentially perpetuating this untruth that these products are somehow less harmful," says Dr. Lawrence R. Deyton, the agency's top tobacco regulator. Altria spokesman Bill Phelps says the company will cooperate with the agency.

Pharmaceutical companies frequently skirmish with the FDA, and Big Tobacco is widely expected to do the same. Altria was the only cigarette maker to support FDA oversight, says Phelps, because it wanted consistent rules of the game for the entire tobacco industry.

Still, this is the second time Altria has clashed with federal regulators in recent months. In March it challenged the membership of an FDA tobacco science panel studying the health risks of menthol cigarettes, which account for more than a quarter of U.S. cigarette shipments. If the panel deems that menthol increases the risk for smokers, the FDA could ban such cigarettes.

On Mar. 22, Altria sent the FDA a 16-page letter requesting the removal of four members of the 12-person panel. The company noted that the four had testified in more than 90 legal cases against the tobacco industry and said that as paid expert witnesses they had "grave financial conflicts and intellectual bias." One of the panelists, Gregory N. Connolly, a tobacco specialist at the Harvard School of Public Health, contends he hasn't been an expert witness in five years and that his research makes him uniquely qualified for the panel. "I take umbrage at Altria's challenge," he says. The three other panelists cited in Altria's letter did not return calls seeking comment. The FDA rejected Altria's request to have the four removed.

Some health-care policy experts and officials at anti-tobacco groups say Al-



The new look of Marlboro Lights

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Russell Simmons, banker 21 ▶

tria's challenge to the FDA may be only the first in a series of battles between Big Tobacco and the government. "This is the beginning of a significant series of regulatory actions by the FDA," says Gregg Haifley, a lobbyist for the American Cancer Society. "The industry will fight this hammer and tong. It will be a titanic fight."

Tobacco czar Deyton says the industry so far has cooperated with the FDA. He adds, however, that if tobacco companies resist new rules and policies, "the law gives [the] FDA quite broad and deep authority to enforce all provisions, everything from issuing warning letters to seizures, injunctions, civil money penalties, criminal investigation—the whole thing."
—Greg Miles, with Chris Burritt and Molly Peterson

The bottom line *Disagreements between Altria and the FDA panel in charge of regulating tobacco could erupt into a full-blown battle.*

Beverages

How PepsiCo Refreshed Its SoBe Water Brand

▶ Sales of its flavored waters are up 85% in a down market

▶ "Over the years we may have lost the true essence and meaning"

Tucked into a corner of **PepsiCo's** sprawling campus in Purchase, N.Y., is a space known to insiders as Adam's room. Decked out with couches upholstered in silver leatherette, a flat-screen TV, and an Xbox 360 video game console, the onetime conference room is designed to resemble the natural habitat of a prototypical 22-year-old male, right down to the pair of sneakers carelessly tossed on the floor.

This is where the crew in charge of PepsiCo's SoBe line of teas and flavored waters retreat when they need to commune with the spirit of their core customer: the demographic category known as millennials. It seems to be working. Sales of SoBe's leading product, a concoction of fruit flavors, vitamins, and herbal extracts named Lifewater, are up 85% in the past year, while

Education

College Degrees Get an Audit

There's no perfect measure of a college education's value—earnings power is but one. Grads of top schools will earn $1 million more than a typical high school grad, according to new research. PayScale, a Seattle-based company that collects wage information, pegs the average 30-year net return on investment for 554 schools at 9 percent. Only 88 schools had an ROI that topped the total return for the S&P 500 over the same period. *—Louis Lavelle*

The Return on Investment

Schools with the best 30-year net ROI over wages earned by a typical high school graduate

School	Total cost	ROI
1. MIT	$189,300	$1,688,000
2. Calif. Inst. of Technology	181,100	1,644,000
3. Harvard	189,600	1,631,000
4. Harvey Mudd	187,700	1,627,000
5. Dartmouth	188,400	1,587,000
6. Stanford	191,800	1,565,000
7. Princeton	187,700	1,517,000
8. Yale	194,200	1,392,000
9. Notre Dame	181,900	1,384,000
10. Univ. of Pennsylvania	191,300	1,361,000

Colleges Compared

30-year net return on investment

Ivies
$1.4mn

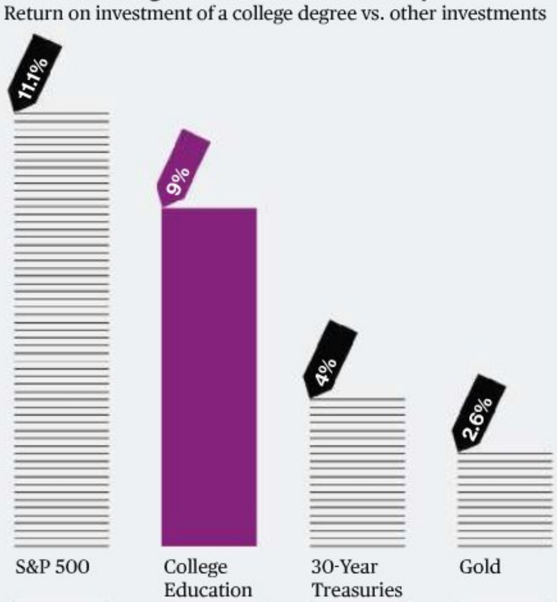
Non-Ivies
$384.4k

Public Colleges
$322.5k

Private Colleges
$559.2k

How a College Education Stacks Up

Return on investment of a college degree vs. other investments



Crunching the data

30-year net return on investment is the difference between the amount earned by graduates from 1980 to 2009 and the earnings of a typical high school graduate, after deducting the cost of obtaining an undergraduate degree. It takes into account the likelihood of never graduating. ROI for public schools in the study was calculated using both in-state tuition and out-of-state tuition; figures shown for public schools include both. Total cost includes tuition fees plus other expenses for the number of years it takes most students to graduate.

DATA: PAYSCALE, BLOOMBERG

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overall sales of bottled water are off 5%.

PepsiCo has been trying to reinvigorate SoBe, a brand it acquired in 2001 from South Beach Beverage for $370 million. That effort took on new urgency in the wake of rival **Coca-Cola**'s $4.1 billion acquisition of Glacéau Vitaminwater in 2007. As the recession was biting, PepsiCo shaved 4¢ off the price of Lifewater, reducing it to an average of $1.18 across different unit sizes. The lower price helped get SoBe into more hands at retail outlets such as **Target**. Lifewater's small share of the bottled water market nearly doubled, to 3.8 percent, for the year ended on May 16. (The data don't include sales at **Wal-Mart Stores**.)

Vitaminwater, meanwhile, hiked prices by 4¢ and saw its hold slip to 11.4 percent from 14 percent for the same period. "I have been surprised by the way the performance gap has shifted," says Mark Swartzberg, an analyst for Stifel Nicolaus, a New York investment bank. "The amount of emphasis they have placed on Lifewater has a lot to do with the success." Vitaminwater says its focus is on building a premium brand, not on fending off lower-priced rivals.

Much of the credit for the reversal goes to Tom Silk, a former U.S. Navy man who traded in his regulation whites 17 years ago to eventually market brands from Pine-Sol to Guitar Hero. PepsiCo beverages chief Massimo d'Amore hired Silk, 42, a year ago and soon put him in charge of the "hydration" portfolio, which includes Aquafina water and Tropicana juices. With SoBe, Silk's mission was to reconnect with the brand's target customers: people born between 1980 and 1995. Says Silk: "SoBe was a trendy brand when the company got it, and over the years we may have lost some of the true essence and meaning."

Even before Silk came on board, PepsiCo had tried its hand at refreshing the brand. For Lifewater, which commands $239 million a year in sales, it designed a new molded-plastic bottle with a wraparound lizard—the reptile is SoBe's mascot. Then, amid headlines about an obesity epidemic, the company introduced a no-calorie version, helping lift sales. Coca-Cola has since introduced a zero-calorie Vitaminwater.

Silk, who oversaw the marketing of video game hits such as *Call of Duty* while at Activision Blizzard, has spent much of the year retooling SoBe's advertising. He recruited Ashley Greene, a star from the vampire movie *Twilight*, to pose in nothing but strategically applied body paint for an ad that ran in *Sports Illustrated*'s swimsuit edition. Videos of the shoot were posted on YouTube and got pickup across the Web. TV spots featuring Greene in what PepsiCo has dubbed her "skinsuit" began airing in May on cable networks such as ESPN, MTV, and Comedy Central. Silk says he's using the Web to discover what resonates with consumers and, "when things get really interesting," put it on TV. "Brands may say that," he says, "but very few people have been successful in doing it."
—*Duane Stanford*

The bottom line *A price cut and Web-savvy advertising are key ingredients in PepsiCo's recipe for boosting sales of the SoBe brand.*



The SoBe crew in Purchase, N.Y., tosses around ideas in "Adam's room"

Energy

Wal-Mart: Blowing Hot And Cold on Wind



▸ **A green project's higher energy rates are unfair, says the retailer**

▸ **"Wal-Mart claims to want wind power but doesn't want to pay for it"**

This spring **Wal-Mart Stores** trumpeted its installation of wind turbines atop light poles at a supercenter (above) in Worcester, Mass. The project, which supplies the store with some of its power, is part of a long-running push to establish a greener corporate image. Despite that effort, the company is unhappy about a high-profile wind farm expected to be built in nearby Nantucket Sound because it means higher rates.

Wal-Mart on June 9 asked the Massachusetts Public Utilities Dept. for a formal voice in discussions surrounding Cape Wind. The wind farm, with a proposed 130 turbines five miles off the Cape Cod coast, was approved by the Interior Dept. in April after nearly a decade of debate. **National Grid**, a utility that delivers power to 28 Wal-Mart stores, has pledged to buy half of Cape Wind's output when it comes online three years from now. The utility has a 15-year contract to buy electricity for 20.7¢ per kilowatt hour, including about 6¢ in state-mandated fees. That's more than double its average cost for power generated by conventional plants. National Grid fore-

FROM TOP: NICOLAUS CZARNECKI/ZUMA PRESS; PHOTOGRAPH BY ERIN PATRICE O'BRIEN FOR BLOOMBERG BUSINESSWEEK; OPPOSITE PAGE: ADIDAS: DAVID LEAH/MEXSPORT/POLARIS; HALL; NICHOLAS RICHER/PATRICK MCMULLAN

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casts this will add $1.59, or roughly 2 percent, to the monthly bill of a typical residential customer.

Wal-Mart doesn't buy electricity directly from National Grid, though it does pay the utility to deliver power it purchases elsewhere. The retailer is concerned about how the $1 billion cost of Cape Wind will be recovered, says spokesman Bill Wertz. Although he has no estimate of the additional costs the company might incur, Wertz says, "We feel it isn't fair to raise rates for people who are not going to receive the electricity directly."

National Grid argues that everyone benefits from clean energy so it makes sense to spread the costs. While Cape Wind entails hefty initial costs, over time it will help lower rates if coal and natural gas prices rise, says Jim Gordon, president of **Cape Wind Associates**, which is building the wind farm. "This project is about transitioning to a cleaner energy future," says Gordon, who hopes to start construction this year. "I'm surprised that Wal-Mart, which is trying to present a green image, would oppose America's first offshore wind farm."

Wertz says the company isn't against Cape Wind. "We would not want our request to be involved in the rate structure to indicate any opposition to the project itself," he says. Yet some analysts say the company supports green projects only when it's convenient. "Wal-Mart claims to want wind power but doesn't want to pay for it," says Adam M. Kanzer, managing director of Domini Social Investments, a green investment fund in New York. "In the long run, sustainability should be more efficient and save us money, but in the transition there are going to be up-front costs. Is Wal-Mart willing to help us make that transition?"

Although the move may conflict with Wal-Mart's messaging on clean energy, it fits with the company's parsimonious image, says Joseph Feldman, an analyst at research firm Telsey Advisory Group. Most of the company's green initiatives so far have led to cost savings, Feldman says. "Wal-Mart's proposition to their customers is to help save them money," he says. "Anything that gets in the way is a hindrance to that."

—Esmé E. Deprez, with Matthew Boyle

The bottom line *Wal-Mart doesn't want to pay more for electricity because of Cape Wind, but the project's backers say it's fair to spread the cost.*

In brief



South Africa and Mexico, both sponsored by Adidas, face off at the World Cup

Adidas
An Early Winner at The World Cup

The world's No. 2 maker of sporting gear raised its annual forecast for soccer-related revenues to at least $1.9 billion, a record. The revision comes after sales of World Cup team jerseys more than doubled from the 2006 tournament. Adidas is sponsoring 12 teams this time around, as well as the event itself. Nike, it's main rival, outfits 10 teams under its own and the Umbro brands.

Dr. Reddy's
An Indian Drugmaker Guns for U.S. Profits

Dr. Reddy's Laboratories stands to reap the biggest windfall among Indian generic-drug makers as $157 billion worth of medicines lose patent protection in the next five years, according to HDFC Securities. The Hyderabad-based company has 73 applications pending before the Food & Drug Administration. If they're approved, Dr. Reddy's will be able to sell generic versions of drugs that generated about $90 billion in sales stateside in 2008. As its share of the U.S. market grows, Dr. Reddy's will also be in a stronger position to negotiate higher prices from drugstores and other clients.

Heinz
Adding New Flavors to Its Condiment Shelf

The world's biggest ketchup maker will step up its presence in China with the $165 million purchase of soy sauce manufacturer Foodstar. The transaction could boost Heinz's annual sales in China to about $300 million from $200 million in the fiscal year that ended in April. Heinz chief William Johnson recently told investors that the company wants to generate one-quarter of all sales from emerging markets by 2016, up from 15 percent at present.

Occidental Petroleum
Prospecting for Investors Offshore

Andrew J. Hall (below), the former Citigroup energy trader whose $100 million bonus became a symbol of Wall Street's excesses, raised $1.1 billion for an offshore commodities fund. Such funds are available to those exempt from paying U.S. taxes, including domestic pension plans. Hall's firm, now owned by Occidental Petroleum, lined up 37 investors for its Astenbeck Offshore Commodities Fund II, according to a filing by the Securities & Exchange Commission.



Lockheed Martin
The Contractor Wins Back a Megadeal

The world's largest defense company won a U.S. military contract valued at $5 billion after a competitor—a subsidiary of L-3 Communications—was barred from new government orders. Lockheed had secured the contract for logistic support services, which covers everything from aircraft maintenance to supporting computers and other electronic equipment, last year. However, that decision was reversed after the L-3 unit complained. L-3 is now being investigated for allegedly abusing its access to a military computer network.

JPMorgan Chase
A Reshuffle Makes Dimon Heirs Apparent

A senior management reshuffle at the biggest U.S. bank may signal that Chief Executive Officer Jamie Dimon, 54, is grooming longtime loyalists as potential successors. Dimon confidant Heidi Miller, 57, was appointed to a new post overseeing all international operations. Michael Cavanagh, 44, was promoted to the top job at Treasury & Securities Services, Miller's old position. The move will give Cavanagh operational experience, a prerequisite for anyone in the running to fill Dimon's big shoes.

Hulu
The Video Website Seeks Content Deals

Hulu is in talks with CBS, Viacom, and Time Warner to add their TV shows to the video site's planned subscription service, people familiar with the discussions say. Hulu, which now lets users watch programs for free and gets its revenue from advertising, is seeking new shows to woo paying subscribers. CBS, the only one of the four major U.S. broadcast networks without a stake in Hulu, may provide programs in September.



Monsanto
Scoring a Legal Win On Alfalfa

In a victory for Monsanto, the U.S. Supreme Court overturned a federal judge's ban on planting alfalfa seeds engineered to be resistant to the company's Roundup herbicide. The 7-1 ruling on June 21 stopped short of allowing farmers to begin planting the seeds, leaving it to the Agriculture Dept. to decide whether to allow limited planting while it completes an environmental impact statement. In Europe, meanwhile, antitrust authorities launched a four-month probe into Monsanto's planned sale of its hybrid sunflower-seed business to Syngenta for $160 million.

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Orszag sees a way to subtly affect decisions on health care and other issues

A Beachhead for The Behavorialists

▶ Obama: Nudging, not commanding, companies and consumers

▶ Is OMB's Sunstein "the most dangerous man in America"?

Peter R. Orszag, the White House budget director, plans to resign this summer, the first member of President Barack Obama's Cabinet to do so. He leaves behind an indelible mark on two of the President's signature issues: the $862 billion economic stimulus plan and the $940 billion health-care reform law, both of which he had a major hand in drafting.

In another, less visible arena, Orszag's imprint could be just as big. He was one of the Administration's most prominent devotees of behavioral economics—the study of what drives consumers to part with their money as they pick one product, retailer, or provider over another. If you give consumers better information and subtly push them in the right direction, the thinking goes, they can be coaxed, not commanded, into buying healthier foods, consuming less energy, and taking out more affordable mortgages.

At the Office of Management & Budget, Orszag, 41, created a team of like-minded adherents, including Cass R. Sunstein (right), Obama's regulatory czar and the co-author of *Nudge*, a behavioralist manifesto. They have quietly established a beachhead,



influencing major sections of the health-care reform law and the financial regulation overhaul Congress is about to complete. Their handiwork can be seen in proposed rules ranging from mine safety to retirement savings, tire durability, and food labels.

Despite criticism from conservatives like Glenn Beck of **Fox News**, and even some apprehension from the political and communications teams at the White House, the behavioralists could be influencing regulations long after Orszag leaves. Their ideas have been seeded in numerous initiatives, just as the regulatory state is poised for a dramatic comeback following decades of retrenchment. Other promoters include Michael S. Barr, the Assistant Treasury Secretary for Financial Institutions, who helped draft Obama's Wall Street reforms. National Economic Council Director Larry Summers and economic adviser Austan Goolsbee are sympathetic, though they don't consider themselves behavioral economists.

Even before Obama was sworn in, his advisers spoke excitedly about plans to reregulate business, in part by adapting the emerging theories of behavioral economics. Then came the ridicule. Republican lawmakers said Obama was creating a nanny state by manipulating American lifestyles with voodoo economics. Fox's Beck launched a crusade against Sunstein, calling him "the most dangerous man in America."

The behavioral adherents lowered their profile. White House advisers made sure of it by rarely allowing them to speak on the record. They've managed to be influential nonetheless. To avoid a partisan fight, Obama's advisers are urging that regulatory proposals not be based on abstract academic theory. Instead, they say, new rules should stress real-world experience and scientific data. The biggest bet will be in health care.

The reform law's premise is that young, uninsured workers can be persuaded to enroll in insurance plans even though it would be cheaper to flout the law and pay a fine as low as $95 in the first year. The behavioralists believe they can use salesmanship and social pressure to make the law's grand bargain work, in which insurers cover everyone and, in return, millions of new, low-cost custom-

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ers pay premiums to subsidize the sick. In Massachusetts, a similar insurance mandate gained 97 percent compliance with an aggressive enrollment campaign that included promotions by the Boston Red Sox.

Already, Obama has adopted behavioralist ideas to encourage more businesses to enroll employees automatically in 401(k) plans and to simplify college financial aid forms. A little-noticed March ruling from Sunstein on a proposed set of tire durability standards is also instructive. The standards were fine, Sunstein concluded, but he demanded more work on labels "to promote easy comparison shopping."

Behavioral economics research stresses the importance of the clarity and salience of disclosures in shaping consumer behavior; the old-fashioned, neoclassical view is that consumers will make use of disclosed information if it's important to them.

White House advisers have clashed with the food industry in pressing for clear, front-of-package nutrition labeling such as rankings on a scale of one to three stars to show whether a product is healthy or not. A provision in the health reform law to require nutrition information on chain restaurant menus was a brainchild of behavioral economists. Health-care adviser Ezekiel J. Emanuel, housed within OMB, is scouring academic and marketing research to figure out how to assure that consumers focus on nutrition information as readily as they do prices."Where's it likely to impact people, and what's most likely to do it?" Emanuel asks. The thinking has even entered the White House's response to the **Massey Energy** mine disaster: Among the ideas under consideration is a name-and-shame website that would clearly compare individual mine safety records.

The consumer financial protection agency in the Wall Street reforms is another vehicle. "Behavioral economics is an impetus for creating the agency," says Harvard economics professor David Laibson. The Treasury Dept. document laying out the Administration's vision for the agency says it's supposed to assure communications with customers are not just truthful but "balanced," and that costs, penalties, and risks are "clear and conspicuous."

Generations of college economics students have been taught that consumers are rational creatures who make financial decisions by weighing price against usefulness. The alternative view, seeping into the Obama Administration, argues it's not just about money. Social pressure and the way choices are presented can be just as important. It's a new role for government: Pennsylvania Avenue as counterweight to Madison Avenue.

—*Mike Dorning*

The bottom line *Behavioral economists in the Administration are leaving a subtle imprint on many regulatory initiatives.*

Behave Yourself

The Obama Administration is weighing rules that rely on the emerging field of behavioral economics. The idea: By giving consumers more information (or simplifying their choices), they can be led in directions the government favors.



Retirement Savings

Problem: Not enough people participate in employer-sponsored retirement accounts.

Solution: Automatically enroll workers in savings plans and let them opt out if they wish. While many large and medium-size companies already had moved to automatic enrollment, the Administration in September issued guidance to make it easier for millions of small businesses to do so.



Higher Education

Problem: Too few children from modest-income families go to college.

Solution: Remove minor roadblocks: For instance, simplify financial aid applications. The Administration a year ago cut the number of questions on the standard financial aid form and this year is allowing online applicants to upload information directly from their federal income tax return.



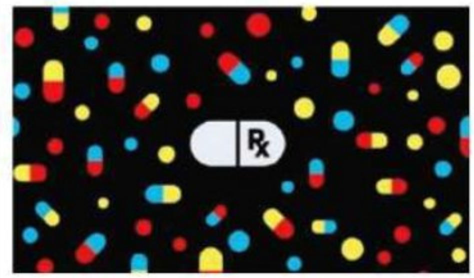
Obesity

Problem: Unhealthy diets contribute to an obesity epidemic and increase health-care costs.

Solution: The Food & Drug Administration is weighing rules for front-of-package food labels. One idea: star ratings for nutritional value. Three stars mean very healthy; one star signals high fat, sugar, or caloric content. The FDA has not decided whether to go with guidance or mandatory rules.

Antitrust

Ending the Silence of Generic Drugmakers



▸ **The FTC says drugmakers are paying generic rivals not to compete**

▸ **"The winds are shifting on the legal front"**

When Jon Leibowitz became chairman of the Federal Trade Commission last year, high on his to-do list was ending drug industry "pay-to-delay" deals. Here's how they work: A generic drugmaker files an application with the U.S. Food & Drug Administration to begin selling a low-cost version of a patented drug. The brand-name drugmaker files suit to prevent approval until U.S. patents expire. Then, the FTC claims, the brand-name company will often pay the generic drugmaker to drop any patent challenges and hold off on bringing its drug to market, delaying pressure from a low-cost alternative to reduce prices.

Leibowitz, 52, a former staff director of the Senate antitrust subcommittee, thinks such agreements are little more than anticompetitive backroom deals, and he's asking a court to stop them. He could find out by August whether victory is possible, some industry lawyers involved in the litigation say. The U.S. Court of Appeals for the Second Circuit in New York is considering whether to review an April decision by a three-judge panel of the court that upheld a 1997 deal between **Bayer** and Barr Pharmaceuticals, now a unit of Israel-based **Teva Pharmaceutical Industries**. In that deal, Barr dropped a patent challenge involving Cipro, the antibiotic that became well known during the 2001 anthrax scare. In return, Bayer paid Barr $398 million over six years. The judges' panel urged a full-court airing, citing the "exceptional importance" of the antitrust issues involved.

ICONS BY MATT OWENS, ILLUSTRATION BY GREG MABLY. OPPOSITE PAGE, FROM TOP: JEFF KRAVITZ/FILMMAGIC/GETTY IMAGES; TOM WILLIAMS/ROLL CALL/GETTY IMAGES

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Leibowitz says that if the full court hears the case and rules against the deal, it could "mark a turning point" in his drive to stop companies "from paying off their generic competitors to sit it out." The fight pits drugmakers against the FTC and President Barack Obama, who has made access to cheaper generics a pillar in his plan to reduce health costs.

The importance of patent lawsuit settlements is growing. Brand-name companies face a spate of expiring patents through 2014 that bring $92 billion in sales, notes research firm IMS Health. Last year, brand-name companies had $250 billion in U.S. sales, says IMS. Generic companies had nearly $36 billion.

Defending patents is vital, says Gerald J. Pappert, general counsel of Frazer (Pa.)-based **Cephalon**. "If the branded company loses, it loses its franchise," he says. Cephalon is fighting a suit, pending in federal court in Philadelphia, in which the FTC and drug wholesalers claim the company paid $200 million to would-be rivals to keep generic versions of Provigil, its sleep disorder drug, off the market. David Stark, general counsel for Teva's North America unit, says the agreements are a proven way of doing business, similar to patent settlements in other industries. The deals, drugmakers say, often lead to generics coming out before the original patent is scheduled to expire, as happened under the Cipro deal.

Leibowitz believes the opposite is true. He says the deals often extend weak patents whose life spans would have been cut short by legal challenges. The FTC also contends that brand-name makers in many pay-to-delay deals give generic companies product licensing rights or other benefits in exchange for an agreement on when cheaper drugs will be introduced. The agency says all this results in consumers paying $3.5 billion annually in higher drug prices, a figure disputed by some economists.

With the potential court review and a bipartisan push in Congress to pass legislation, the FTC's "lonely voice," as Leibowitz puts it, may finally be heard. "The winds are shifting on the legal front, on the commission front, and on the legislative front," says Robert W. Doyle Jr., a former FTC official.

—Jeff Bliss and Susan Decker

***The bottom line** The FTC's push to speed generic drugs to the market could get a legal boost this summer with a possible appeals court hearing.*



Simmons claims he's only trying to help the little guy

Financial Regulation

Def Jam's Founder Out-Lobbies Big Banks

- Russell Simmons wins an exemption for his debit cards
- Cards are "exploitative of the poor and minorities"

It was surely the only time that lawmakers hammering out the financial regulation bill were lobbied by a man wearing a hoodie and New York Yankees baseball hat. That's how Russell Simmons showed up on Capitol Hill earlier this month to fight a proposal to cap the fees retailers pay banks to process debit-card payments.

Simmons, best known for his Phat Farm clothing line and Def Jam music label, is also the owner of **UniRush**, a Cincinnati company that sells a prepaid **Visa** debit card called RushCard, with about 2.5 million users. Simmons has persuaded lawmakers to exempt his business from a measure that would shift more of the cost of debit-card processing from retailers to the banks.

When a consumer uses a debit card, the retailer's bank pays a 1 percent to 2 percent "interchange fee" to the card holder's bank. The merchant ultimately shoulders that cost, and it adds up. Retailers estimate they pay nearly $20 billion a year to debit-card issuers such as **Citigroup** and **Bank of America**. If the interchange fee is capped, Simmons says, he would be forced to charge his low-income customers more, allowing retailers like **Wal-Mart Stores** and **Best Buy** to profit the most.

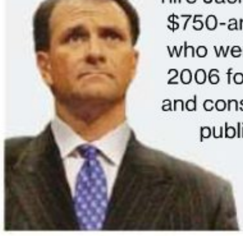
Simmons' prime target, Richard J. Durbin of Illinois, the No. 2 Senate Democrat, has for years pushed to reduce interchange fees on behalf of retailers. Durbin won an amendment to the financial overhaul legislation that passed the Senate in May to cap the fees and let the Federal Reserve set the rates, instead of Visa and **MasterCard**. Credit-card fees would not be affected. The end result means more profits for retailers and less for Simmons. Big card-issuing banks, unpopular with politicians after the $700 billion industry bailout, got nowhere in their effort to defeat the provision.

Enter Simmons, who used his star power to open doors in Washington. He railed against Durbin's provision on a Huffington Post blog and a Twitter feed read by about 364,000 people. He argued that prepaid debit cards are essential for low-income people who can't afford checking accounts or would be turned down for credit cards. His customers load money onto a RushCard, which is accepted anyplace that takes Visa. In an open letter to lawmakers, published on the Huffington Post site, he says he aims only to help the little guy: "I don't work for Visa or Master-

Quoted

"So much has happened since then. He didn't know what an iPad was."

—Ron Rosenbluth, owner of Tov Pizza in Baltimore, describing new hire Jack Abramoff, a former $750-an-hour lobbyist who went to prison in 2006 for defrauding clients and conspiring to bribe public officials, to *The Baltimore Sun*.



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Card and I don't give a damn about the profits of the big banks. Regulation is long overdue."

Unmentioned are the fees Simmons' company imposes for its card, including a $9.95 monthly charge, $3 for activation, $1 for every purchase if a PIN is used, $1 for online bill paying, and 50¢ to check your balance at an ATM. Direct deposits and online account management are free, as is a service that alerts customers when their balances are low. By comparison, check-cashing services can charge $50 to cash a $1,000 paycheck. Such fees have led some to ask whether Simmons is at least as interested in doing well as in doing good. Simmons is "marketing a product that is frankly exploitative of the poor and minorities," says Georgetown University law professor Adam Levitin, who specializes in banking issues. "He's no different than a bank."

That's not how lawmakers backing Simmons see it. "The poor, already struggling in the midst of the worst economic crisis since the Great Depression, cannot withstand this double-barreled assault on their benefits and dignity," says Representative Gregory Meeks (D-N.Y.). To make his case, Simmons focused on a handful of Congressional Black Caucus members, including Meeks and Maxine Waters (D-Calif.). Another prepaid-debit-card entrepreneur, Robert Johnson, the founder of **Black Entertainment Television**, also got involved, sending Waters a personal note urging her to oppose the Durbin amendment.

In the end, Durbin was won over: He announced on June 21 that he would exempt prefunded debit products, including the RushCard, from the fee limits. "This will protect the fees on the most vulnerable, which is what I care about the most," Simmons said in a statement. The big banks haven't been as lucky: The legislation the Senate and House may vote on this month still targets their higher fees.

$20 billion

Amount of fees banks collect from merchants that take debit cards

—Robert Schmidt and Patrick O'Connor

The bottom line *Invoking low-income consumers, Russell Simmons won an exemption from legislation that could have hurt his debit-card business.*



Monetary Policy

A Very Big Man with a Very Big Job at the Fed

- **William English will help determine when to lift rates and sell assets**
- **"A slight mishap and he could send markets for a reel"**

William English, the Federal Reserve economist about to become Chairman Ben S. Bernanke's top monetary policy adviser, has a knack for being in the right place at the right time. As a grad student at Massachusetts Institute of Technology, he counted Bernanke, then a 29-year-old visiting professor from Stanford University, among his teachers. As a Yale University undergrad in 1980, English (above) wandered into the gym where the varsity fencing team was practicing; the sophomore was recruited on the spot because of the competitive edge his 6-foot, 10-inch frame offered.

Now, with the retirement of his boss, monetary affairs director Brian F. Madigan, and Fed Vice-Chairman Donald L. Kohn, who had run the division for 14 years until 2001, the 49-year-old English is about to become one of the central bank's most important players. Much like fencing, the new job requires mental agility, including crafting how and when the central bank will reverse the most expansive monetary policy in its 96-year history without deep-sixing the U.S. economy along the way. The task is "about as challenging as any director of that post has ever had," says former Fed Governor Lyle Gramley, now senior economic adviser at Potomac Research Group in Washington. "Markets have become extremely sensitive to every word the Fed puts out, so a slight mishap and he could send markets for a reel."

Allan H. Meltzer, a historian of the Fed, has faulted the monetary affairs staff for being "far too supportive" of Bernanke's bailouts and emergency loans during the 2008 financial panic, actions that he thinks may have compromised the Fed's independence. "It's a difficult job in the best of times," Meltzer, a professor at Carnegie Mellon University in Pittsburgh, says of English's new post. "And these are not the best of times."

Nicknamed "Big Bill," English takes over monetary affairs as the Fed debates when to start raising its benchmark interest rate from close to zero and how quickly to sell $1.1 trillion of housing debt the Fed bought during the recent crisis. "These are economic issues that academics are going to be thinking about for generations," English said in an interview last month. "I'm sitting in the middle of it, trying to make sense of it in real time."

The youngest of four children, English grew up in West Hartford, Conn., where finance was part of the dinner table conversation. His father, James, was chief executive officer of Connecticut Bank & Trust in the 1970s and served on the Federal Advisory Council, a group of bank executives that advise the Fed.

FROM LEFT: ANDREW HARRER/BLOOMBERG; SACRAMENTO BEE/ZUMA PRESS; FRED PROUSER/REUTERS

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English will lead a team of about 90 staff members responsible for compiling the confidential Bluebook, which outlines policy choices for the rate-setting Federal Open Market Committee. The team also runs the discount lending window for banks and conducts a quarterly survey of commercial bank lenders.

Helping Bernanke select the right language to signal the pace and timing of a rate change, possibly in the first quarter of 2011, now falls to the new director. The trick is to come up with words that allow maximum flexibility while not surprising investors. At the end of the June 22-23 FOMC meeting, the Fed stuck to its pledge to keep the main rate low for "an extended period," the phrase it has used since March 2009. —*Scott Lanman*

***The bottom line** A new monetary policy director starts at the Fed just as it debates how and when to reverse the most expansive moves in its history.*

For Techies, No Contest

As of May 19, Democratic Senator Boxer had raised $229,000 from computer and Internet companies, while Republican challenger Fiorina, the former Hewlett-Packard CEO, raised $46,000.



Carly Fiorina

DATA: CENTER FOR RESPONSIVE POLITICS

Barbara Boxer

California Politics

The Choice in the Valley Is Boxer Over Fiorina

- Former eBay CEO Whitman is winning tech leaders' favor
- "It makes it a harder hill to climb for Carly"

When Carly Fiorina, the former head of **Hewlett-Packard**, and Meg Whitman, **eBay**'s former chief executive officer, won their June 8 Republican primaries for the U.S. Senate and governor's office in California, the next-day narrative was upbeat: Voters had smartly chosen two competent technology executives with proven leadership skills.

Two weeks later a more sobering reality is hitting Fiorina. She faces a wall of opposition from her Silicon Valley peers, even as Whitman retains their loyalty and Democratic incumbent Barbara Boxer, Fiorina's Senate rival, boasts numerous technology executives in her corner. **Cisco Systems**' John Chambers, who often backs Republicans, is a Boxer fan. Also standing behind her are **Oracle**'s Larry Ellison, **Netflix**' Reed Hastings, eBay CEO John Donahoe, **Autodesk** CEO Carl Bass, **Symantec** Chairman John Thompson, and John Doerr, the venture capitalist.

Fiorina's tech supporters are less numerous: The short list includes **Intel** CEO Paul Otellini and **Kleiner Perkins Caufield & Byers** co-founder Tom Perkins. "There's a lot of animus about her business decisions at HP," says Barbara O'Connor, director of the Institute for the Study of Politics & Media at California State University, Sacramento. "It's mostly the Compaq decision and how she handled it," O'Connor says, referring to Fiorina's bitterly fought 2001 acquisition of Compaq Computer, a $19 billion deal meant to help HP regain its lost market value. The strategy backfired, and HP lost its personal-computer market lead to **Dell**, resulting in Fiorina's 2005 ouster.

"It isn't surprising that a three-term incumbent senator is supported financially by many in the tech industry," Amy Thoma, a spokeswoman for Fiorina, says of Boxer. "Carly enjoys a broad range of support both from the Silicon Valley and throughout the state."

The rebuff stiffens Fiorina's challenge of beating a Democrat in a heavily Democratic state. "It makes it a harder hill to climb for Carly," says Jim Cunneen, a Republican state assemblyman in Silicon Valley from 1994 to 2000 and now a principal at political consulting firm California Strategies in San Jose.

Contrast that with Whitman, who's racking up funding from Chambers, **Yahoo!** co-founder Jerry Yang, former **Apple** finance chief Fred Anderson, **Intuit** CEO Brad Smith, former Oracle operating chief Ray Lane, and **Microsoft** CEO Steve Ballmer. Whitman faces California Attorney General Jerry Brown in the November gubernatorial race; the $54 million she raised through May 22 is more than triple Brown's take, according to the California Secretary of State.

Boxer, 69, spent years nurturing Silicon Valley by backing more H1-B visas to bring technology engineers to the U.S. from overseas and, in 2004, opposing rules forcing companies to account for employee stock options as an expense, saying that would make it harder to attract top talent. "Over the years, Barbara has worked with our industry on critical issues impacting Silicon Valley, including education, promoting innovation, stock options, and tax policies, even when she's faced opposition from many colleagues," Chambers, 60, said in an e-mail. As of May 19, Boxer had raised $16.3 million, more than double Fiorina's $7.4 million, according to the nonpartisan Center for Responsive Politics. From computer and Internet companies, Boxer took in $229,000 to Fiorina's $46,000.

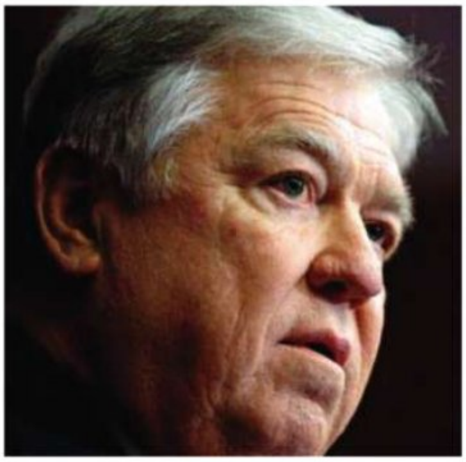
Among voters overall, Boxer leads Fiorina 48 percent to 43 percent, according to a June 9 Rasmussen poll, almost within the 4.5 percent margin of error. Still, with unemployment in California near 13 percent and the state home foreclosure rate the nation's fourth-highest, it could be a difficult year for incumbents, Cunneen says. "This election is really about jobs and the economy," he says, "and there aren't many jobs and the economy is still sputtering." —*Ari Levy*

***The bottom line** Fiorina's six years at Hewlett-Packard aren't winning her much love—or money—from Silicon Valley.*

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Charlie Rose talks to

Haley Barbour



The Mississippi governor's state is being hammered by the BP spill, but he's reluctant to criticize Obama and defends continued deepwater drilling

What impact has the spill had on tourism?
Today, our beaches are still pristine and beautiful. We've had no oil reach the Mississippi shoreline. Twice we've had a very small volume of emulsified oil—kind of an orange glob that has washed ashore on one of our barrier islands 12 miles offshore. But our tourist season has been devastated. It didn't matter what the hotel or the inn said, the tourist who was 500 miles away just couldn't accept that because of the way the news coverage made it look.

You've been measured in your criticism of the President.
First of all, this shouldn't be about politics. This is a very serious episode that could end up being catastrophic. At the same time, I've been willing to say, as I said about the Bush Administration after Katrina, it did a lot more right than it did wrong. They had some mistakes early. The same thing is true of this Administration. And any time you have an unforeseen, unprecedented disaster of this magnitude, it's silly to think everything's going to go like you hoped. I will say about this Administration, they have tried to do everything we've asked them to, and in fairness, so has BP. But right now we are seeing that the command-and-control system the government set up is not serving us very well.

Why is that?
I don't know anything about maritime operations, but in this case, the Coast Guard went for quite a long period of time without the ability to communicate with the resources we had worked hard to make available to defend our shores. So we asked them please get that done, and it's starting to be done. Again, that's not something that I'm going to attack the Administration over, but it's a shortcoming that is very material to us in these days when we're starting to see oil come at us. Three or four weeks ago we thought we had a good defense plan.

Will this be defined as a political issue in the midterm elections?
When Americans look at me as governor, or any other governor, the question they ask is: "Can he get the job done? Can he get the problem solved?" That's what they expected after Katrina. That's what they expect when any problem arises. And so they'll look at this Administration and say: "Did they get the job done?" Is that expecting too much?

Having been through this crisis, when the citizens of Mississippi say to you, "Governor, do we really have to drill offshore, do we have to take this risk?"—what do you say?
Yes. And there are about four reasons why I say that. First of all ... some 25 percent of all the U.S. oil production today is in Gulf of Mexico deepwater. So reducing the amount of oil we produce means commensurate increases in the importation of foreign oil, something we've been trying to reduce for 40 years. Secondly, the four Gulf states that allow drilling—Alabama, Mississippi, Louisiana, and Texas—have done so for more than 50 years. More than 30,000 wells have been drilled in the Gulf, and this is the first time anything like this has ever happened. I suspect we will see, when all the evidence and the facts are in, that the proper procedures were not followed in the attempt to shut down the well, and that's what caused the blowout. The third thing: Of the 10 worst oil spills in American history, this is the worst, but it's also the only one that was caused by an oil well. Seven of the 10 were caused by tankers leaking oil. If we're going to start importing a bunch more oil, we're going to increase the chances of oil spills. And finally, this has huge economic impact on my state—but nothing like the economic impact on the total U.S. economy.

Looking at all the casualties—whether it's the ecosystem or the economy—will there be a rethinking of our energy priorities and the necessity for a different kind of energy strategy?
As the President said in his speech the other night, those who advocate that, like he does, have no idea how to get there. Look at how many nonfuel products we make from petroleum, from makeup to plastics to many, many, others. So we're going to be using a lot of oil for a long, long time. And we need to be honest about that. We need more American energy, not less. The way to import less oil is for us to produce more oil in the Gulf and on Western lands that could be opened to drilling and in Alaska. I remember when President Clinton vetoed the bill in 1995 or so to allow drilling in ANWR, he said we wouldn't get the oil for 10 years or so anyway. Well, wouldn't we have loved to have had that oil for the last five or six years. So to sum up your question: Do I think this BP spill is going to be the Chernobyl or Three Mile Island of offshore drilling? I don't think so.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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EXECUTIVE DIRECTOR/CEO

Location: Lagos, NIGERIA

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The Luncheon will be hosted by Mrs Christine LAGARDE, French Minister of Economy, Industry and Employment.
Christian SAUTTER, Deputy Mayor of Paris, will open the second day of the Forum.

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Technology



As Mobile Shopping Takes Off, eBay Is an Early Winner

▶ **Sales via smartphones and tablets are the fastest-growing business at the e-commerce giant**

▶ **"We pick and choose what will move the needle, and then we do it fast"**

Tim L. Fields bids on jewelry, art, and antiques on **eBay**, sometimes in 30 to 40 auctions at one time. The New Orleans attorney spends hours in court and away from his PC, so he gets his shopping done using an eBay application on his iPhone that sends alerts when he's been outbid or when a sale is about to expire. "It's sort of an addiction," says Fields, who has used the eBay mobile app to buy a $15,000 set of antique French silver.

After losing ground to **Amazon.com** for years in online retailing, eBay has emerged as a leader in a new market: mobile commerce. As consumers increasingly shop with their BlackBerrys, iPhones, and handsets powered by **Google**'s Android software, such as the Motorola Droid, eBay has become the top mobile retailer in the U.S., say analysts. Consumers are even buying cars with their eBay apps: The most expensive example this year is a used Lamborghini Gallardo Spyder that went for $139,000. In 2010, the San Jose (Calif.) company expects to move $1.5 billion worth of goods through its mobile apps—more than double last year's $600 million. Tablet computers, too, are moving the merchandise: Users of eBay's app on **Apple**'s iPad spend three or four times as much money

Most expensive car bought this year on an eBay mobile app:



2007 Lamborghini Gallardo Spyder for **$139,000**

ILLUSTRATION BY HARRY CAMPBELL

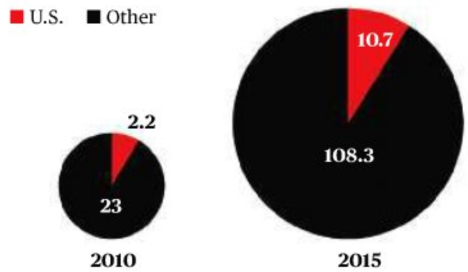
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Technology

Shopping on the Go

Top sales categories in eBay mobile, by value:
1. Cars & Trucks
2. Apparel
3. Sporting Goods
4. Auto Parts
5. Computers

Mobile commerce industry, in billions of dollars
Data: eBay; ABI Research



in a typical session than they would on an iPhone, says Steve Yankovich, eBay's vice-president for mobile.

While mobile is still a small part of eBay's $8.7 billion in total revenue, it's a booming market. By 2015, mobile commerce will grow into a $119 billion global industry, up from $18.3 billion last year, according to analyst Mark Beccue of ABI Research.

It's also a fragmented market: eBay claimed about 3.3 percent of it, and Amazon, with $275 million in global sales volume, accounted for 1.5 percent, says Beccue. The worldwide mobile leader, which handled an estimated $800 million of merchandise in 2009, is Taobao, a unit of Chinese Web giant **Alibaba Group**. (Amazon and Alibaba do not disclose revenues from mobile.) "The companies that drove e-commerce from the early days of the Internet are now taking the lead when it comes to mobile commerce," says Michael Gartenberg, analyst of digital media at Altimeter Group.

So far, eBay has produced 14 mobile apps that let users buy, sell, and hunt for deals. Yankovich says he is aiming for a production pace of one app every five weeks. "We pick and choose what will move the needle, and then we do it fast," he says. Last year, for example, Yankovich and his team added the feature that alerts mobile shoppers on the status of auctions. "Sales shot up," he says. "It was instant money." On June 23, eBay announced its acquisition of RedLaser, a mobile app that uses a cell phone's camera to scan bar codes.

John Donahoe, 50, eBay's chief executive officer of two years, says the company will roll out apps tailored to specific product categories. The first one, eBay Fashion, will display popular items and deals in a slideshow that users can browse through by swiping their finger on a touchscreen. The app will also offer a kind of virtual dressing room; if you find a shirt you like, for example, you can use your phone's camera to superimpose an image of the shirt on an image of you.

Such blending of real-world and virtual shopping could be the beginning of a trend, says Yankee Group's Nick Holland. Amazon has an app that lets users snap a photo of a product and see comparable items and prices online. (Amazon spokesman Craig Berman declined to comment.)

Yankovich says he's still discovering what works with shoppers. "Nobody knows what's going to happen in mobile," he says. "We need to be ready to spin on a dime."

—*Douglas MacMillan and Joseph Galante*

The bottom line *Mobile commerce is booming and still fragmented. eBay is rapidly introducing shopping apps to stay ahead of Amazon, its main U.S. rival.*

Software

How Adobe Is Battling The Flash-Bashing

▶ **Steve Jobs calls it a buggy battery hog and won't use it in the iPhone**

▶ **"We expect Flash to be part of all the devices that count"**

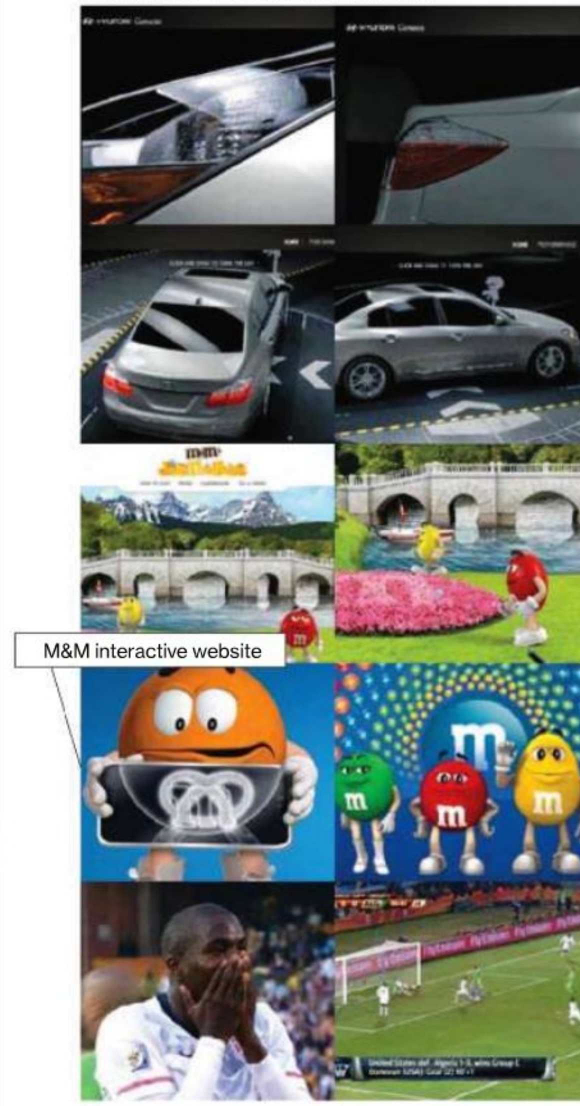
In the fast-moving world of mobile devices there are many battles brewing. The one to watch may be the standoff between **Adobe** Chief Executive Officer Shantanu Narayen and **Apple** CEO Steve Jobs over Flash, the Adobe software that brings interactivity to millions of websites.

"Flash looks like a technology that has had its day," Jobs said at a tech conference earlier this month. In his view, Flash is a bug-ridden battery hog. He favors HTML5, a still-evolving Web technology that does many of the same things as Flash.

In an interview at Adobe's headquarters in San Jose, Calif., Narayen comes across as soft-spoken and measured—not the kind of guy to do battle over competing Web standards. Ask him if the dispute over Flash amounts to a "war," as Jobs has called it, and he smiles. "The words to describe it are irrelevant," Narayen says. "To us, this is about where computing is headed."

The Flash Player software, which is free, powers most of the Web's intro screens, video shorts, inserted commercials, dancing typography, and interactive graphics and is installed on 98 percent of personal computers worldwide. It's used by about 85 percent of the top 100 websites, delivering 70 percent of Web games and 75 percent of Web video, Adobe says. By the company's count, 19 of the top 20 mobile handset makers

The Flash-Powered Universe



NARAYEN: MARTIN KLIMEK/ZUMA PRESS

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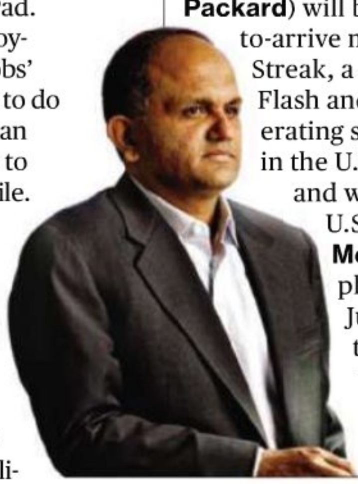
Hyundai Genesis website



ESPN's online World Cup coverage

are committed to building smartphones that support Flash. The lone holdout is Apple and its iPhone and iPad.

Narayen, an Apple employee from 1989 to 1995, says Jobs' gripes about Flash have less to do with the technology itself than the Apple chairman's desire to dominate the future of mobile. "Whenever there's disruption that happens in computing, there are wars that happen that enable people to get disproportionate market share," says Narayen (right). "You saw that in the PC era when whoever controlled the applications was able to get dominant market share. Apple is looking at Flash and saying that it keeps them from being able to have the kind of closed system that they would like." Apple did not return calls for comment. Unlike Flash, HTML5 is a nonproprietary technology. No single company owns it.



Adobe is banking on a new version of its player, called Flash 10.1, to prove to the market that it continues to be relevant in the world of smartphones and tablet computers. Although the new software was in the works before Jobs went public with his criticisms, it does address a number of his complaints. Flash 10.1 is designed to make video run more smoothly on mobile devices, while also supporting iPhone-like touchscreen gestures such as pinching fingers to shrink a photo, or widening them to zoom in. Adobe says the new application is also better at conserving battery power.

The Flash Player itself contributes little to Adobe's bottom line; the company makes money selling tools to software programmers who build on the technology. The real revenue generator for the company is the Adobe Creative Suite, a collection of graphic design, video editing, and Web development applications that use Flash technology. On June 22, Adobe posted record revenue of $943 million for the second quarter, representing 34 percent year-over-year growth, which the company attributed to strong demand for the latest version of Creative Suite.

Adobe's goal in coming months is to get Flash up and running on as many new mobile devices as possible. **Nokia**, **Research In Motion**, and **Palm** (recently bought by **Hewlett-Packard**) will be using Flash on soon-to-arrive mobile phones. The **Dell** Streak, a 5-inch tablet that uses Flash and Google's Android operating system, was introduced in the U.K. earlier this month and will hit shelves in the U.S. later this summer. **Motorola**'s new Droid 2 phone, set for launch on June 23, the day before the official release of the iPhone 4, also is expected to use Adobe's technology.

Adobe isn't betting that HTML5 goes away. Rather, the company believes it will develop over the years as a technology complementary to Flash, and is creating tools that will work with both. "Ideally, I'd love to see a ubiquitous platform across all devices," says Steve Jackson, president and CEO of **Smashing Ideas**, a Seattle-based digital media studio that produces content for the **Cartoon Network**, **Disney Channel**, **Nickelodeon**, and other companies. "But we've been hoping for that for a decade. We're going to continue to create content across multiple platforms, and that certainly includes both Flash and the iPhone."

Google, which has been waging its own battles with Apple, is emerging as an important ally to Adobe. Flash will be part of the recently announced Google TV, which aims to put Web content on **Sony**-manufactured TV sets powered by Google's Android. Sometime in the coming months, Google is expected to release its own tablet computer that will also support Flash.

"We expect Flash to be part of all of the devices that count," says Narayen. "I think it's going to be an incredible holiday season." —*Tom McNichol*

The bottom line *Adobe is getting its Flash software on many smartphones, even though Steve Jobs is knocking it.*

189

DOLLARS

Cost of the Kindle. Amazon shaved $70 off the price of its e-reader on June 21, the same day Barnes & Noble lowered the price of its Nook e-reader by $60, to $199

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Technology



Running a Swedish empire page 37 ▶

Computers

Why the Mac Is Still A Rock Star at Apple

▶ The computers fetch 30 percent gross margins

▶ "It's a real testimony to the power of the Mac brand."

Whatever happened to the Macintosh computer? During Steve Jobs' June 7 address at the Worldwide Developers Conference to introduce the new iPhone, the **Apple** chief executive only mentioned the word "Mac" twice in two hours. That followed the disappearance of Apple's "I'm a Mac" TV ads from its website.

In the first quarter of 2010, the iPhone accounted for 40 percent of sales, vs. 28 percent for the Mac. In the same period a year ago, it was 27 percent for the iPhone and 33 percent for the Mac. "It's a different company than it used to be," says Gene Munster, an analyst at Piper Jaffray. "It's not a traditional computer company. It's a mobile devices company."

The rise of the iPhone notwithstanding, the Mac is still a big part of Apple (a BBW50 company), which dropped "Computer" from its name in 2007. Macs sell for an average price of $1,300 with 30 percent gross margins, says Munster. By comparison, consumer-grade Windows machines sell for half that, or $687, according to research firm IDC. That's why Apple's relatively small slice of the U.S. market—only 6.4 percent in the first quarter of 2010, says IDC, up from 4 percent in 2005—doesn't matter much. For every half-point in market share Apple takes from Hewlett-Packard, Dell, and all the other Windows vendors, it boosts its sales by about $3 billion, Munster says.

The better indicator is unit sales, which have grown substantially. In fiscal 2004, Apple sold 3.29 million Macs for the whole year. It sold slightly more than that—3.36 million—in the first quarter of fiscal 2010 alone. Charles Wolf, an analyst with Needham & Co. in New York, estimates that Apple will sell nearly 13 million Macs in 2010. "It's a real testimony to the power of the Mac brand that Apple sells these machines for nearly twice what the Windows competitors charge, and yet the sales keep growing faster than the rest of the industry," Wolf says.

There's also evidence that Apple is plotting to keep its edge. According to patent filings, future Macs may boast such features as embedded projectors that turn any nearby wall into a display for PowerPoint or the latest movie downloaded from iTunes. Newer products may also lure customers to consider the Mac. "It's a symbiotic interplay," Wolf says. "Once you get an iPhone or an iPad, you get exposed to the entire Apple gestalt in the Apple retail stores." —*Arik Hesseldahl*

The bottom line *The iPad and iPhone get all the raves, but the Macintosh computer line remains a cash-spinner.*

STENBECK: AKE GUNNARSON/VUE



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Telecom

A Hedge Fund's Big Bet on 4G

▶ Harbinger's network must be ready for 100 million Americans by 2012

▶ "It's a triple bank shot with a twist," says one industry player

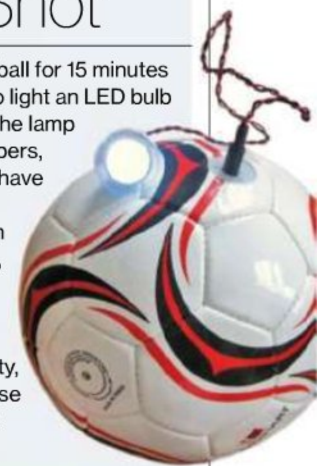
Philip Falcone's **Harbinger Capital Partners** has placed a large and risky bet on 4G wireless Internet service by paying an estimated $500 million for **SkyTerra Communications**. The hedge fund's filings with the Federal Communications Commission lay out a plan to build 36,000 radio towers and send up two satellites. The spectrum Harbinger picked up in the deal could be worth up to $7 billion, based on a **Credit Suisse** analysis of the value of wireless licenses. Harbinger spokesman Joshua Lefkowitz declined to comment for this story.

Falcone generated billions shorting subprime mortgages and going long on steel. Like most hedge funds, though, Harbinger lacks a track record running companies, and the deal is a gamble whether the firm pursues a national rollout or sells the spectrum to another company. To get FCC approval for the SkyTerra deal, Falcone committed to building a wireless network that can serve 100 million Americans by the end of 2012. By 2016 the network must cover 260 million people. If Harbinger misses these targets, the FCC can declare its rights to use SkyTerra's spectrum "null and void," according to a March FCC filing.

Harbinger will need as much as $4 billion to build its network, including $1 billion for the satellites, says Tim Farrar, president of Telecom, Media & Finance Associates. "It's a triple bank shot with a twist," says Matthew J. Desch, chief executive officer of **Iridium Communications**, a satellite company in McLean, Va. "I wish them well."

Harbinger has plans for 4G network trials in Phoenix and Denver by September 2011. Its more established rivals will have a long head start: **Sprint** already offers 4G services with partner **Clearwire**. **Verizon Wireless**, the largest U.S. mobile provider, will begin rolling out its 4G network later this year. **AT&T**, the second-biggest U.S. wireless player,

Product Shot



Kicking a sOccket soccer ball for 15 minutes produces enough power to light an LED bulb for three hours—just plug the lamp into its socket. The developers, four friends from Harvard, have drummed up $40,000 to run pilot programs in South Africa, Liberia, and Nigeria, and plan to have sOccket on the market for playing and plugging in months. Besides providing electricity, sOccket may reduce the use of fume-emitting kerosene lamps. —*Caroline Winter*



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Innovator

Anil Duggal



The GE scientist had trouble selling his radical idea: Flexible, light-producing sheets that may soon outshine the bulb

The lightbulb, once a symbol of General Electric's ingenuity, has shrunk to such a small percentage of its sales over the years that GE tried, unsuccessfully, to sell off the business in 2008. As it turns out, the Connecticut-based conglomerate has been directing a research effort at making the screw-in bulb obsolete. Anil Duggal, a physical chemist at GE's research labs in upstate New York, says he may be about a year away from producing durable and green lighting that is neither incandescent nor fluorescent.

The technology is called organic light-emitting diodes (OLEDs, not to be confused with LEDs, a different technology), and it could revolutionize the way the world is lit. GE's OLEDs will come in rolls of flexible sheets less than a tenth of an inch thick, and Duggal says their energy efficiency now matches compact fluorescents—with room for improvement. Their pliability opens the door to light-producing furniture, wallpaper (or ceilingpaper), and items that have yet to be imagined.

Like GE co-founder Thomas Edison, who improved Humphry Davy's lightbulb, Duggal is taking OLEDs, which have existed for decades, and focusing on how to mass-produce them. OLEDs glow when electricity flows through naturally occurring organic polymers. GE is betting on a process that "prints" the polymers onto plastic film and sandwiches them with a top layer of film. The long sheets can be made at high speed, producing rolls of OLEDs.

First, Duggal had to develop a genius for getting funded. The idea of manufacturing lighting with a method akin to newspaper printing was a tough sell. In the late '90s, he managed to buttonhole U.S. Energy Dept. officials visiting GE to look in on other projects. The $1 million grant that resulted helped keep the project going. Then in 2001, Jeff Immelt, still new in the role of CEO, challenged GE engineers and scientists to strive for breakthrough ideas. Today, OLED and LED research get about half of GE's R&D budget for lighting.

The lighting sales of market leaders Siemens, Philips Electronics, and GE now add up to $17 billion a year. Research firm Frost & Sullivan estimates the current market for OLED lighting, which is even and diffuse compared with single-point sources like bulbs, at $77 million a year. That could rise rapidly if architects and developers adopt the technology. All GE's major rivals are working on OLEDs, but Duggal's manufacturing process and his flexible product may prove to be a huge advantage for GE, says Frost & Sullivan analyst Abhigyan Sengupta.

As a student, Duggal, 44, was torn between philosophy, religion, and the physical sciences. His drive to solve tangible problems won out: "My personal dream was to change the world...technology-wise." Before that happens, GE, Duggal—and the outside designers who will be given sheets of the stuff—must figure out how to turn this new material into products on store shelves. Ⓑ —*Rachel Layne*

Pivotal Moment ▶ **Dropped his philosophy studies to solve tangible problems**

Lifeline ▶ **An Energy Dept. grant floated him until GE got on board**

Challenge ▶ **Designs that make his lighting technology marketable**

Technology

plans to introduce 4G service next year. So-called 4G, or fourth-generation, networks offer mobile service at speeds that exceed some of the broadband connections people get in their homes.

Although selling its wireless licenses is an option for Harbinger, there are difficulties with that as well. AT&T and Verizon, the most likely purchasers of Falcone's spectrum, are restricted from buying more than 25 percent of the SkyTerra spectrum without FCC approval—although both companies are trying to change that rule. The agency would approve a larger spectrum sale only if it views the deal as being in the public interest, says Paul de Sa, chief of the FCC Office of Strategic Planning & Policy Analysis. AT&T has filed a petition with the FCC to rescind the restrictions on spectrum license sales, arguing that they are "entirely arbitrary." —*Greg Bensinger*

The bottom line *Harbinger Capital paid an estimated $500 million for an embryonic 4G wireless provider, bringing it spectrum licenses worth up to $7 billion.*

Online Media

Microsoft's Bing Goes Hollywood

▶ **The search engine now offers TV shows and music**

▶ **"We see a great opportunity," says a Microsoft executive**

On June 22, **Microsoft**'s Bing search engine began letting users locate and watch TV shows without leaving the site, a feature meant to keep people from going to the likes of **Google**. Bing now offers access to 20,000 full-length episodes of 1,500 TV programs posted at Hulu, YouTube, and network sites. Using Microsoft's Zune music service, Bing also provides one-time access to 5 million full-length songs and then clips afterwards. A Microsoft survey found that 76 percent of Bing users want one destination for entertainment options to eliminate clutter. "We see a great opportunity," says Microsoft's Yusuf Mehdi. Ⓑ —*Andy Fixmer*

The bottom line *A Microsoft survey found that Bing users want less clutter. Offering media within the site may help Bing compete against Google.*

PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK

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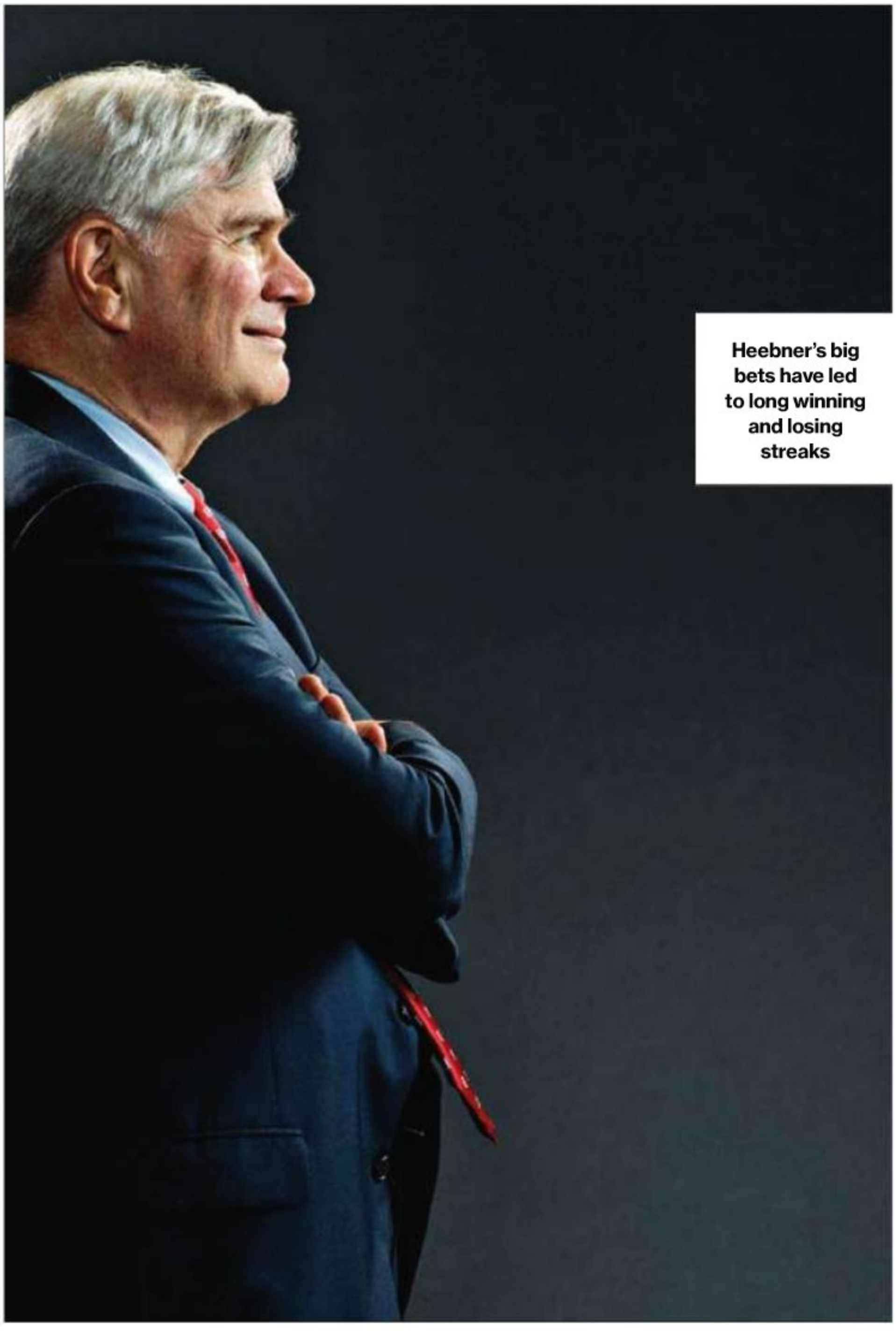
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Markets&Finance

The Manager with the Hot Hand Goes Cold

▶ **Ken Heebner's CGM Focus, once the hottest mutual fund, has lagged its rivals since 2008**

▶ **"He's been in all the wrong sectors at all the wrong times," says Morningstar's Rahbar**



Heebner's big bets have led to long winning and losing streaks

DAVID YELLEN

Ken Heebner started the century making all the right moves for his CGM Focus mutual fund. Deftly shifting into and out of sectors such as homebuilding and commodities, he posted returns averaging 32 percent annually from 2000 through 2007, a period when the Standard & Poor's 500-stock index returned just 1.7 percent a year. Then the magic stopped. CGM Focus, which Heebner runs from Boston, is the only domestic stock fund to trail at least 96 percent of its peers in 2008, 2009, and again this year, according to research firm Morningstar. The main culprits: bad bets on commodity and financial stocks. "He's been in all the wrong sectors at all the wrong times," says Jonathan Rahbar, a Morningstar analyst.

Even with the losses, Heebner is holding his spot atop the 10-year chart. CGM Focus returned an average of 17 percent a year in the decade ended May 31, the best record of more than 3,200 U.S. diversified mutual funds, Morningstar's data show. In second place was Lord Abbett Micro Cap Value, which gained 14 percent. Heebner, 69, the co-founder of **Capital Growth Management**, launched CGM Focus in 1997; it has returned 13 percent a year since then. He also manages CGM Mutual, which has returned 4 percent a year for the past decade, and CGM Realty, which gained 19 percent annually over the same stretch. He declined to be interviewed for this story.

Heebner's nosedive rivals that of Bill Miller, the high-profile **Legg Mason** fund manager who beat the S&P 500 for a record 15 consecutive years, then dropped to the back of the pack from 2006 through 2008. Like Miller, Heebner has lost investors, with net withdrawals of $1.8 billion since August 2008, according to Morningstar.

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Kibbutzim get into green biz page 41 ▶

CGM Focus' assets are now $3 billion, down from a peak of $10.3 billion in June 2008, reflecting market losses and investor withdrawals. Unlike Miller, he lagged the market last year, gaining 10 percent while U.S. stock funds on average rose 33 percent. Miller's Value Trust was up 41 percent. Steven Rogé, who invests his clients' money in mutual funds, says the ballooning of Heebner's assets in 2008 convinced him there were better places to invest. "When a fund attracts assets that quickly, we worry about a manager's ability to handle it," says Rogé, whose firm, R.W. Rogé, oversees $200 million.

Heebner is known for building big stakes in specific industries and for shifting gears quickly. CGM Focus' top 10 holdings represented 73 percent of assets of as Mar. 31, vs. 31 percent for the typical fund, according to Morningstar. The fund's turnover ratio, a measure of how much the portfolio changes in a year, is 464 percent, more than four times greater than peers. Heebner also bets on falling stock prices by selling short, a strategy that many funds don't pursue.

In 2000 and 2001, Heebner profited by betting against technology stocks. At the same time he began buying shares of homebuilders, such as **Lennar**, before the boom in construction and home prices. By the start of 2005, before homebuilding stocks began their decline, he had sold them and moved into energy and commodity companies. The price of oil more than tripled between the end of 2004 and the middle of 2008. "Historically he has done phenomenally well knowing when to rotate," says Rahbar.

More recently his moves have been ill-timed. Returns faltered in the second half of 2008, when Heebner's holdings in energy, metals, and agriculture stocks began to tumble. After selling the commodity stocks he bought financials, including insurers such as **Hartford Financial Services**, according to filings with the Securities & Exchange Commission. "The escalating financial crisis took its toll on these issues during the fall," Heebner wrote in the fund's 2008 annual report. CGM Focus dropped 48 percent for the year, compared with a decline of 37 percent by the S&P 500.

Heebner sold his insurance holdings at a loss in the first quarter of 2009. That hurt: Many of those stocks soared after the market reached a 12-year low in March. Hartford almost tripled in the final nine months of 2009. Heebner is getting back into commodities and sticking with financial stocks. In the first quarter he bought new stakes in mining companies, including **Cliffs Natural Resources** and **BHP Billiton**, according to a May 14 regulatory filing. Metal and mining stocks accounted for 36 percent of his holdings as of Mar. 31. Bank stocks represented 16 percent of the portfolio.

So far the strategy isn't paying off. CGM Focus fell 6.3 percent this year through June 15 as the S&P 500 rose 0.9 percent, including dividends. **Goldman Sachs**, CGM Focus' second-largest holding, lost 19 percent. Its third-biggest stake, miner **Freeport-McMoRan Copper & Gold,** dropped 16 percent. **Ford Motor**, its top position, was up 16 percent.

The declines since 2008 "don't indicate Heebner has lost his talent or his expertise," says Ronald Sugameli, manager of the $130 million New Century Alternative Strategies Portfolio, a mutual fund that invests in other mutual funds. CGM Focus represented about 1.5 percent of Sugameli's fund as of May 31. While he expects Heebner's performance to bounce back, the fund manager isn't planning to boost his holdings of CGM Focus. Given the fund's volatility, Sugameli says, "it is best used in small doses." —*Charles Stein*

***The bottom line** Managers like Heebner who make big bets are prone to volatile returns; investors must hope profits during hot streaks make up for the losses.*

Quoted

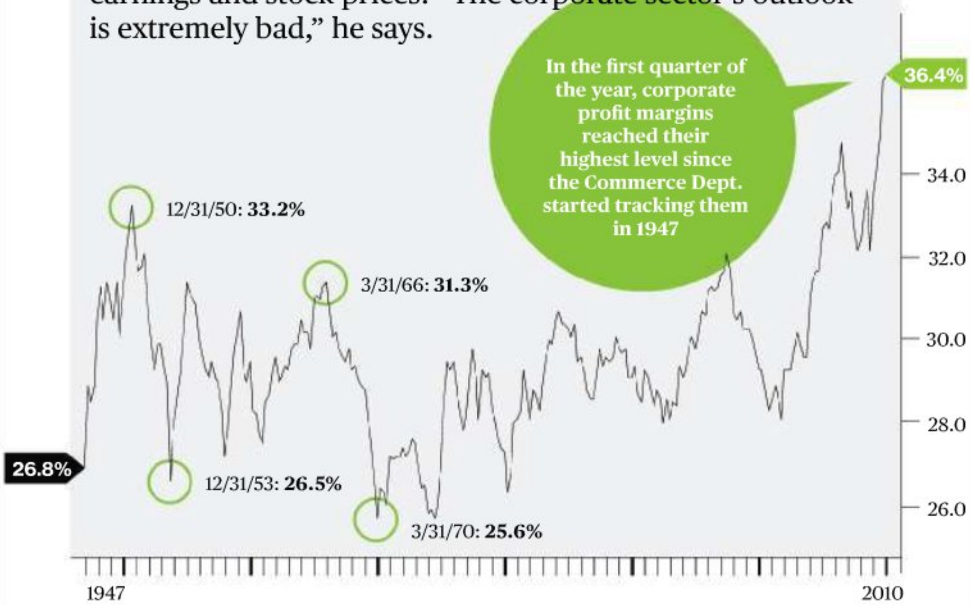
"The Germans do worry a lot about inflation, and basically that's because they're crazy. It's just not going to happen with a massively depressed economy."
—Nobel Prize-winning economist Paul Krugman, speaking at a conference in Tel Aviv on June 22



Corporate Scorecard

Profit Margins May Be Poised to Fall

Profit margins for U.S. companies rose to a record last quarter. That's a worrisome sign to economist Andrew Smithers, who believes they will decline sharply as governments slow their spending next year, denting earnings and stock prices. "The corporate sector's outlook is extremely bad," he says.



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Global Stocks

Emerging Markets Set the Pace in IPOs

▶ Companies in developing nations raise more cash

▶ "The investor appetite is just not there" in industrialized countries

Emerging markets are outpacing advanced economies in bringing companies to market. Initial public offerings in China, India, Poland, and other developing nations raised $29.3 billion in the April-to-June period, almost three times the amount raised in industrialized markets. Emerging markets have won the IPO contest in each of the past five quarters, the longest run since at least 1999, according to Bloomberg data.

The streak could continue next quarter, when **Agricultural Bank of China** sells up to $28 billion of stock in Hong Kong and Shanghai. "The investor appetite is just not there right now" for IPOs in industrialized nations, says Robert Froehlich, senior managing director at Hartford Financial Services Group.

Stock markets around the world declined over the past three months. Investors worried that the global economic recovery will slow, as countries including Greece, Portugal, and Spain struggle to fund their debts. At least 47 initial offerings worldwide have been shelved since March.

While emerging markets were not immune from the decline—the MSCI Emerging Markets Index sank as much as 18 percent this quarter—companies, many of which were government-owned, pushed ahead with their share sales. State-controlled **PZU**, Poland's biggest insurer, raised $2.7 billion in April in Europe's largest initial offering since 2007. The IPO was part of Poland's efforts to raise as much as $10 billion from asset sales to help finance a widening budget deficit and curb borrowing. **SJVN**, the state-owned operator of India's largest hydropower plant, raised $236 million in an initial offering in May.

Ken Fisher, chief executive of Fisher Investments in Woodside, Calif., believes investors seeking big payoffs will continue to snap

➔

The Financial Life

Cristina Stenbeck



The American-born head of Sweden's second-largest family investment firm has managed the empire she inherited by steering a careful course

When Jan Stenbeck announced in 1999 that his 21-year-old daughter, Cristina, would succeed him as head of **Investment Kinnevik**, Sweden's second-largest family-controlled holding company, even she was surprised. Three years later, Jan died of a heart attack, and she was in charge. In her eight years at the top, she has focused on incremental change rather than remade the company, and that is how she plans to continue. "I don't think you'll see Kinnevik investing outside of industries and markets that aren't known to us today," says Stenbeck, now 32. "Kinnevik today allows us to achieve what we want to achieve."

Stenbeck lives in London and travels to Stockholm for board meetings. Mia Brunell Livfors, 44, who became chief executive in 2006, runs the company day-to-day. Major stakes in two publicly traded companies form the bulk of Kinnevik's holdings: **Tele2**, the Nordic region's first major phone discounter, which Jan Stenbeck created, and **Millicom International Cellular**, the phone company that operates in emerging markets from Guatemala to Tanzania. Millicom now has more than 30 million customers in 13 countries. Stenbeck is closing or selling unprofitable units in Western Europe and expanding the phone operations in emerging markets such as Russia and Africa. She is also making small investments in microfinance in Africa and farming in Russia.

Investors seem to approve. Kinnevik's shares have more than doubled since the end of 2008, giving it a market value of $4.4 billion. The Wallenberg's **Investor**, Sweden's biggest family-controlled investment company, worth $13 billion, gained 15 percent over that period. Some analysts say Stenbeck's moves may not have a big impact on the company's bottom line. "They're doing the right things and investing in the right areas," says Bo Nordberg, an analyst at Christopher Street Capital in London. "But these new ventures are extremely small and don't move the needle in the grand scheme of things."

Stenbeck, who with her family controls 48.3 percent of Kinnevik's voting rights and 17.4 percent of its equity, has a fortune estimated by the *Sunday Times* to be $345 million. Born in New York and raised there by her American mother, she graduated from Georgetown University and didn't learn Swedish until she was 18. She and her husband, Alexander Fitzgibbons, have a daughter and are expecting twins. Asked at a conference in Stockholm in February how she would manage a family and a career, Stenbeck said: "Ask Hans-Holger, he has seven kids." She was referring to Hans-Holger Albrecht, chief executive of **Modern Times Group**, a Kinnevik holding that is a leading broadcaster in Scandinavia and the Baltics. The audience applauded. B —*Jacqueline Simmons and Niklas Magnusson*

Company ▶ **Investment Kinnevik, with a market value of $4.4 billion**

Major holdings ▶ **Tele2, a phone company, and Millicom, a cellular provider**

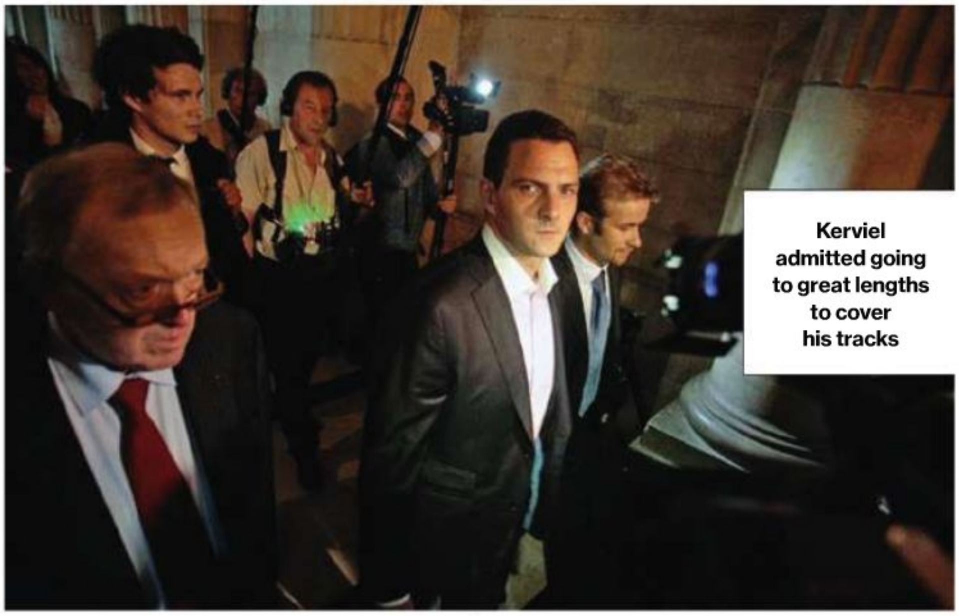
Strategy ▶ **Make incremental investments, not major acquisitions**

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up developing-market IPOs. Emerging economies tracked by the International Monetary Fund are forecast to expand 6.3 percent this year, almost three times the 2.3 percent projected for advanced economies. "Emerging markets have a fundamental growth force behind them, which tends to make people more optimistic about them," says Fisher. "That quality makes people more prone to take a flyer on something in the emerging markets, where they wouldn't want to in the developed world."
—*Michael Tsang and Lee Spears*

The bottom line *As developed economies struggle with heavy debt loads and sluggish growth, investors seeking big gains are turning to emerging markets.*


Kerviel admitted going to great lengths to cover his tracks

Trials

Kerviel Says He Was 'Moronic' and Innocent

- ▶ The former SocGen trader argues his superiors encouraged him
- ▶ Management "saw me exceed the limits. Nobody was worried"

Testimony in the trial of Jérôme Kerviel, accused of the biggest rogue-trading scandal in history, ended with an emotional confrontation. On June 22 in an ornate 19th-century courtroom near Paris's Notre Dame cathedral, the former trader who nearly sank Société Générale came face to face for the first time with Daniel Bouton, the French bank's former chief executive who stepped down after the scandal. Bouton, his voice shaking on the stand, called Kerviel "a liar" who created "a fraudulent enterprise within the bank."

It was a dramatic conclusion to three weeks of testimony that laid bare the mechanics of Kerviel's trades—as well as severe weaknesses in the bank's management and risk-control systems.

Kerviel built his defense on the idea that his former bosses encouraged him to take oversized positions, then turned on him when his bets went bad. Comparing his superiors to traffic cops, he told the court that "the police saw me exceed the limits. Nobody was worried." The bank denied that accusation. Kerviel's own testimony showed he went to great lengths to cover his tracks. He admitted logging fictitious transactions into the bank's computers, forging e-mails, and lying to controllers. He told the court that he realized in hindsight that his actions had been "moronic."

Still, testimony showed that the bank missed scores of chances to stop him. Kerviel amassed $61 billion in unhedged market positions that led to a $6 billion trading loss when they were unwound in January 2008. Bouton acknowledged that SocGen had neglected back-office controls. "We did not look enough at operational risks," he told the court.

In July 2005, just weeks after Kerviel became a trader on the bank's Delta One desk, he was caught making an $18 million market bet, more than five times the limit for traders on his desk. "They should have fired him immediately," says Catherine Lubochinsky, who runs a program at Pantheon-Assas University in Paris that trains future traders. Instead, Kerviel was allowed to keep his job. By the time Kerviel was caught in January 2008, his trades had triggered at least 75 internal alerts, as well as questions from German authorities. Witnesses described the bank's control systems as so fragmented and overburdened that they generally accepted traders' explanations without further investigation. One controller, Marine Auclair, recalled that Kerviel justified a trade by showing her documents that later proved to be faked. "I never called the back office to see if the transactions were confirmed," she testified. "That wasn't my job." Auclair said Kerviel promised her a bottle of champagne for clearing up the problem but never delivered it.

The trial, which was slated to end on June 25 after closing arguments, was heard by a panel of three judges who aren't expected to issue a verdict for months. Kerviel, 33, faces up to five years in prison and $464,000 in fines if convicted.

Kerviel's defense had "tremendous difficulties explaining why he had to forge documents if he felt that he was being transparent and his hierarchy knew," says Stephane Bonifassi, a white-collar criminal defense lawyer with the Paris firm of Lebray et Associés who is not connected with the case. "This is a big chink in his armor."

Evidence of SocGen's flawed oversight, by itself, probably isn't enough to acquit Kerviel, says Stephen J. Brown, a finance professor at New York University's Stern School of Business. Brown, who has studied Nick Leeson, the Singapore-based rogue trader who brought down the former Barings Bank, says there was "ample evidence that his supervisors looked the other way" when Leeson exceeded his trading limits. The trader pleaded guilty to fraud after his arrest in 1995 and was sentenced to 6½ years in prison. Says Brown: "These cases always involve a very significant lapse of supervision." —*Carol Matlack and Heather Smith*

The bottom line *Société Générale had many chances to stop Kerviel, but that may not protect him from a guilty verdict.*

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OPPOSITE PAGE: CYRIL BITTON. THIS PAGE, FROM TOP: CHRISTIE'S IMAGES/BLOOMBERG; SOTHEBY'S/BLOOMBERG; BLOOMBERG; EMMANUEL DUNAND/AFP/GETTY IMAGES

Personal Investing

Complex CDs for 'Nervous Nellies'

- Banks promise safety and the potential for higher yields
- Savers can get "similar returns without all the complications"

With interest rates near historic lows, **Wells Fargo**, **Sovereign**, and other banks are offering certificates of deposit tied to equity indexes, commodities, or currencies. The pitch: They're safe—backed by the Federal Deposit Insurance Corp.—and could pay out more than conventional CDs. But they're complicated, and buyers could end up earning little or no interest.

"Market-linked CDs are a great selling tool [to appeal to] nervous Nellies," says Thomas Balcom, founder of Ibis Wealth Management in Boca Raton, Fla. Wells Fargo sold about $5 billion of its market-tied CDs last year. Sovereign's, which bet on the performance of the Standard & Poor's 500-stock index, have attracted $1 billion since October. Yet "there are other ways to get similar returns without all the complications," says Thomas Orecchio, principal at Modera Wealth Management in Westwood, N.J.

Sovereign's market-linked CD comes as a package consisting of a conventional six-month CD paying 2 percent interest and a three-year CD that pays 2.9 percent each year that the S&P 500 is higher than on the purchase date. If the index hasn't gained ground, the owner gets no interest for that year. The minimum investment is $5,000, split evenly between the two CDs.

Safety-minded investors can create something similar to a market-linked CD using a Treasury security known as a zero-coupon bond, which is sold at a discount to the maturity value. For instance, earlier this month a saver with $1,000 could have laid out $910 to buy a $1,000 zero-coupon bond maturing in 2015, and invested the remaining $90 in a stock index fund. B

—*Margaret Collins and Zeke Faux*

The bottom line *Investors who put money into market-linked certificates of deposit may end up earning little or no interest.*

Bid & Ask





Art Market

An Edouard Manet self-portrait sold for **$33.2 million** at a Sotheby's auction in London—an auction record for the artist. The 1878 canvas, *Self-Portrait with a Palette*, went to New York-based dealer Frank Giraud. The previous owner bought the painting for $18.7 million in 1997.

Food

$1.2bn

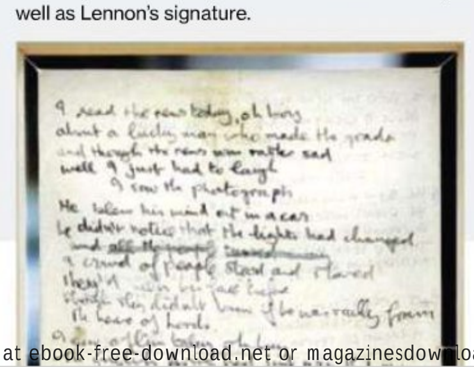
The price St. Louis-based Ralcorp agreed to pay for American Italian Pasta, the biggest maker of dry pasta in North America. Ralcorp, which provides cereal and other products that retail chains sell as their own store brands, has purchased more than 20 companies in the past decade.

Pharmaceuticals

Biovail, Canada's largest publicly traded drugmaker, will merge with Aliso Viejo (Calif.)-based Valeant Pharmaceuticals International, establishing a company with annual sales of **$1.75 billion**. The combined businesses will focus on treatments for central nervous system illnesses and skin ailments, as well as branded generic medicines for developing countries, according to a joint statement. The deal is expected to close by yearend.

Collectibles

John Lennon's handwritten lyrics for the Beatles masterpiece *A Day in the Life* sold for **$1.2 million** at a Sotheby's auction in New York. The double-sided document features crossed-out words, corrections, and additions written in different colors, as well as Lennon's signature.


I read the news today, oh boy
about a lucky man who made the grade
and though the news was rather sad
well I just had to laugh
I saw the photograph
He blew his mind out in a car
he didn't notice that the lights had changed
a crowd of people stood and stared
the house of lords.

Energy

$2.5bn

The price Norway's Acergy agreed to pay for another oil services provider, Subsea 7. The goal of the merger, to be completed by the end of this year or in the first quarter of 2011, is to establish a global leader in seabed-to-surface engineering and construction.

Collectibles

A porcelain sign that once marked the intersection of Wall and Broad streets, near the New York Stock Exchange, sold for **$116,500** at Christie's in Manhattan. Marks on the two enamel plaques, which are set crosswise and framed by cast iron, indicate that the sign may have survived the 1920 bombing in New York City's financial district that killed 38 people.



Yachting

Belgian textile heiress, art historian, and licensed passenger-ship captain Ineke Bruynooghe is selling the *SS Delphine*—the last operational steam-powered superyacht afloat. The yacht, where Roosevelt, Churchill, and Stalin supposedly met to prepare the Yalta Convention at the close of World War II, will go on sale with an asking price of **$47 million**.

Chemicals

$3.8bn

The price BASF, the world's largest chemicals producer, paid for German food- and cosmetics-ingredients maker Cognis. Buying Cognis will add about $3.2 billion in sales and reduce BASF's reliance on plastics and chemicals that Middle East competitors manufacture more cheaply.

Box Office

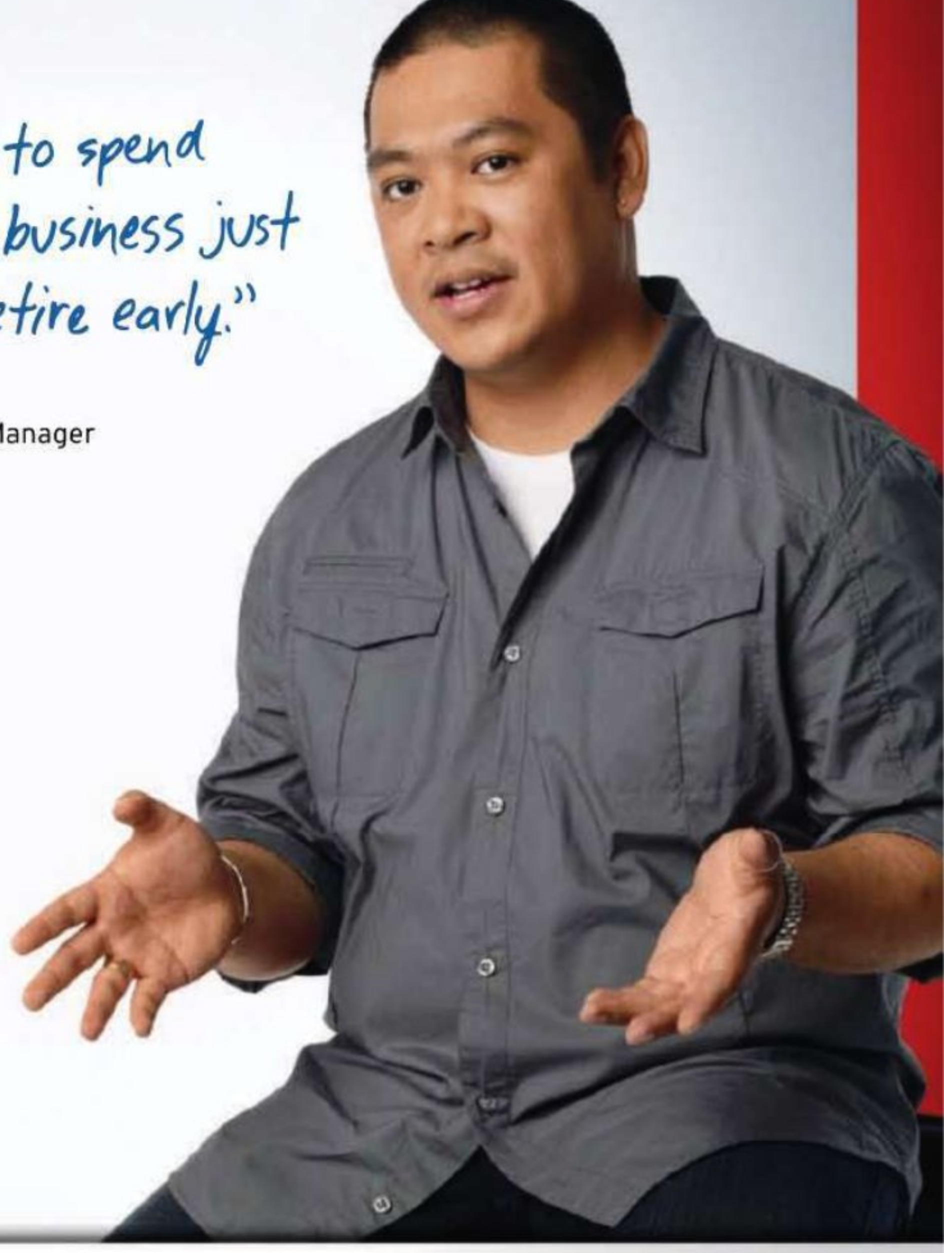
Toy Story 3 grossed **$109 million** in ticket sales during its debut weekend, a record for Pixar, which produced the film. The first 3D sequel of the animated series is Pixar's 11th box office debut at No.1. The *Toy Story 3* opening is the second-highest for an animated feature, falling between *Shrek The Third* ($121.6 million) and *Shrek 2* ($108 million). Pixar is owned by Walt Disney.

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LAST YEAR ALONE CYBERCRIMINALS STOLE OVER $40 MILLION FROM SMALL BUSINESS BANK ACCOUNTS.*

"You don't want to spend years building your business just so a hacker can retire early."

Jamz Yaneza
Threat Research Manager
Trend Micro



Like any good predator, cybercriminals go for the easy kill, and small businesses are a prime target. Using malicious software called *bots* hackers break into computers, steal banking pass codes, and drain cash from small business accounts before anyone notices. Many victims actually have an Internet security solution in place at the time of attack, but it just isn't good enough. Trend Micro's Worry-Free™ Business Security is different. It provides all-in-one protection that stops attacks like these before they reach you. You just set it and forget it. We do the rest.

Think your current Internet security is good enough? Think again.
Try our free Threat Protection Toolkit and see what's getting through.
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Focus On **Enterprise**



Abramowitz aims to supply 10 percent of Israel's energy needs with solar

PHOTOGRAPH BY URIEL SINAI FOR BLOOMBERG BUSINESSWEEK

Israel's Kibbutzim Shift From Red to Green

▶ As they drift away from socialism, the collectives are launching environmental businesses

▶ Clean energy "just comes as a natural direction for kibbutzniks"

Members of Kibbutz Ketura, a collective farm in Israel's Arava Desert, share meals under the fluorescent lights of a spartan dining hall. The kibbutz's leaders earn the same pay as the laundry folders: nothing, other than occasional dividends and monthly allowances. Anyone who wants a new air-conditioner to make it through the infernal desert summer has to sign up on a waiting list. Yet Ketura's commitment to socialism hasn't stopped it from forming a partnership with German industrial giant **Siemens**.

Siemens last August paid $15 million for a 40% stake in **Arava Power**, a company affiliated with the kibbutz that hopes to start generating solar power this year. "The partnership works well for both sides," says Eliezer Tokman, chief of Siemens Israel. "The guys at Arava are the entrepreneurs. They initiate projects and deal with regulation, and we design, build, and maintain the projects."

Like Ketura, many kibbutzim are moving into environmental businesses. Since the 1980s, when soaring interest rates and skyrocketing inflation brought many of the agrarian collectives close to bankruptcy, they have branched out from farming. As they morph into a more pragmatic form of egalitarianism, they typically maintain a keen awareness of the environment. "Tapping the sun's energy is only natural given our geographical location and the general inclination of the kibbutz's members for ecological pursuits," says Yosef I. Abramowitz, a student activist turned green entrepreneur who in 2006 founded Arava with Ketura members.

On June 22, Arava announced contracts with three Bedouin families to put solar installations with 20 megawatts of potential output on their land in the Negev Desert, near the Red Sea. That project will be funded with up to $80 million in loans from the Overseas Private Investment Corp. (OPIC), a U.S. government agency. Arava is trying to raise at least $500 million more to install photovoltaic arrays at 15 kibbutzim. The company aims to build capacity of 1,000 MW, roughly 10 percent of Israel's current energy needs. "We're never going to be Rockefellers," Roy Kagan, manager of Ketura's businesses, says between phone calls and text messages. "But we are still very

The social upheaval in Greece page 52 ▶



competitive and profit-oriented."

For some kibbutzim, the green roots go deep. At Kibbutz Dalia, there's a dilapidated blacksmith shop where a handful of members in 1941 started making water meters. They rightly believed the meters would help settlers conserve water on arid land in what was then known as Palestine—and, they hoped, supplement their meager proceeds from farming the rocky terrain near the port city of Haifa. Today, the original building stands in the shadow of a factory churning out millions of meters annually that are used as far away as Britain and the U.S. Total sales are about $100 million annually. Clean technology and green energy projects "just come as a natural direction for kibbutzniks," says David Zakai, export manager at **Arad Group**, the Dalia-owned company that makes the meters.

$15 million

Amount Siemens paid for a 40% stake in Kibbutz Ketura's solar power business

Kibbutz Hatzerim, in the Negev Desert, owns **Netafim**, one of the world's largest makers of smart irrigation systems, with annual sales of over $500 million. The company started in 1965, when the kibbutzniks teamed up with an engineer who discovered that a slow and balanced supply of water led to improved plant growth. Kibbutz Sde Eliyahu, founded in 1938 by German immigrants, was an early convert to organic farming. In 1992 the kibbutz founded **Bio-Bee Biological Systems**, which sells bees for crop pollination and insects that eat other bugs to reduce the use of chemical pesticides.

The kibbutzim often cooperate on green projects. Water-meter maker Arad is a joint venture between Dalia and a neighboring kibbutz. Ketura is part of a cluster of a dozen desert kibbutzim involved in green projects, including solar energy, waste-water recycling, and an educational program to teach alternative building and organic gardening techniques. A water filtration business affiliated with Kibbutz Beit Zera, on the shores of the Sea of Galilee, in January was bought by a similar outfit owned by the nearby Kibbutz Amiad.

Like Ketura, with its Siemens and OPIC partnerships, more kibbutzim are bringing in foreigners as they pursue green businesses. Kibbutz Na'an, between Tel Aviv and Jerusalem, sold half its stake in **Na'an Dan Irrigation** to India's **Jain Irrigation Systems** for $35 million. **Chromagen**, owned by Kibbutz Sha'ar Ha'amakim, sells some $50 million in solar water heaters annually and controls about 25 percent of the Israeli solar-water heating market. In April, Chromagen agreed to cooperate with Milwaukee-based **A.O. Smith** to start offering its products to Americans. "The partnership will allow us to target the U.S. market, which has barely been penetrated," says Amit Shvartz, vice-president of marketing at Chromagen. "It's a good feeling knowing that we are not only feeding mouths and trying to increase revenues, but we are also selling something that is eco-friendly." *—David Wainer*

The bottom line *As kibbutzniks adopt a more pragmatic socialism, many have launched thriving green technology and clean energy businesses.*

Unsolicited Advice

Esther Dyson, angel investor and Internet pioneer

Once entrepreneurs take an investment, they give up control. If their investors refuse to put more money in, others will say: "Why isn't blah-blah reinvesting?" Unless they have a good reason, that makes it really hard to get funded by anybody else. As an investor, I'm very open-minded, but in the end I'm not going to ask a company if it's innovative. I'm going to ask them if this is useful to somebody. Do the basics, then innovate in what you're offering. But remember: Innovation is not a benefit. Usefulness is a benefit.



Dyson has invested in about 100 startups. She just completed cosmonaut training.

Cash Flow

Busted State Budgets Mean Late Payments



- ▶ Some contractors are forced to wait nearly a year to collect on bills
- ▶ Delays "make vendors unwilling lenders to the state"

Craig Thompson has seen his share of deadbeat buyers of the audio, video, and security systems he installs and maintains. He never expected his state government would be the worst offender. Illinois owes $470,000 to **Thompson Electronics**, some of it billed almost a year ago. This float to the state equals about 7 percent of Thompson's $7 million in annual revenues and has depleted nearly a quarter of his company's $2 million line of credit. "We might reach a point where we just can't do any more business [with Illinois] because we can't afford it," says Thompson (above).

As states struggle with shrinking tax revenues, they're squeezing contractors to bridge budget gaps. "The practical impact of a state's declining or delaying payments is to make its vendors unwilling lenders to the state," says Robert Metzger, a partner in Los Angeles with law firm Pillsbury. His clients received some of the $2.6 billion in IOUs that California handed out last summer. That money has since been paid off.

Illinois has $5 billion in unpaid bills to vendors and institutions such as school districts, the state comptroller reports. It's a spreading problem: State tax revenues are forecast to drop

THIS PAGE, FROM TOP: JOCK FISTICK/BLOOMBERG; PHOTOGRAPH BY RUDY ARCHULETA FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATION BY ANDY FRIEDMAN. OPPOSITE PAGE: AKIMENKO MEATS; AARON PANONE

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Raising Capital

Eight Companies Kick-Started by Fans

Kickstarter.com helps creative people fund art, films, music, and quirky businesses. Users post fund-raising targets online and ask friends and strangers to pledge money in exchange for CDs, T-shirts, or free products. Almost anything but equity. More than $1.5 million has been pledged to the 5,000 projects on the site. Below are some of the businesses that have received backing. —*John Tozzi*



Diaspora

Backers **6,479**

Goal	Amount Raised
$10,000	**$200,642**

Four NYU students upset by Facebook's privacy policies set out to build an open-source alternative and raised 20 times their goal.



Brooklyn Grange Rooftop Farm

Backers **391**

Goal	Amount Raised
$20,000	**$23,227**

Five co-founders got the funds needed to buy 1 million pounds of soil and other supplies for a one-acre rooftop farm with views of the Manhattan skyline.



KaboingTV.com

Backers **346**

Goal	Amount Raised
$16,800	**$20,874**

Veteran animator Joe Murray raised money to start a Web channel to feature his own cartoons and those of other artists.



Little City Gardens

Backers **243**

Goal	Amount Raised
$15,000	**$20,395**

This small San Francisco garden, which sells to local residents and restaurants, raised enough money to expand to more than half an acre.



MakerBeam

Backers **132**

Goal	Amount Raised
$10,000	**$17,922**

Three co-founders are creating a building system of aluminum beams, connectors, and brackets that work something like oversized Legos or Tinker Toys.



Akimenko Meats

Backers **201**

Goal	Amount Raised
$15,000	**$16,405**

Vadim Akimenko plans to open a butcher shop to supply Bostonians with meat from animals raised on organic farms within 250 miles of the city.



Lumi

Backers **188**

Goal	Amount Raised
$12,000	**$13,598**

Lumi developed a process for printing detailed photographic images on natural materials such as leather to make bags, wallets, and other fashion accessories.

gyst

GYST

Backers **78**

Goal	Amount Raised
$10,000	**$10,505**

This artist-run maker of business software helps visual artists market their work. GYST used its cash to create a new version of the program.

2.3 percent this year, according to the National Governors Assn. For the budget year that begins July 1 in most of the country, 46 states face deficits —a combined shortfall of $112 billion, according to the Center on Budget & Policy Priorities. "You could see additional states having to do things like delay payments," says Nicholas Johnson, a director at the center.

The New York State legislature failed to pass a budget for the fiscal year that started Apr. 1, so lawmakers began passing weekly spending bills to keep the state operating. For eight weeks these "extenders" didn't include money owed to many contractors, though by early June, payments for work billed in April were going out. "If [contractors] are used to being paid in two or three weeks, it's probably six or seven weeks now," says Steve Stallmer, vice-president of government affairs of the Associated General Contractors of New York State, a trade group.

Painful as waiting for payments may be, tight budgets likely portend an even bigger problem for small companies working in the public sector: a dearth of new contracts. In New York, nearly $1.2 billion in public construction jobs that contractors have bid on since January have not been awarded because of the budget impasse, Stallmer says.

Back in Illinois, Thompson spends hours every week calling the comptroller's office, state agencies, and lawmakers. "Last week, after lots and lots of phone calls, we did get $20,000 from them," he says. "They just say, 'We'll put you on a list, and if we have money we'll pay you.'" —*John Tozzi*

The bottom line *Some states don't have enough cash to pay bills on time, and floating loans to the government can wreck small businesses' cash flow.*

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COMCAST BUSINESS CLASS

LESSONS LEARNED

Lesson 3: Partnering for Profit

Small businesses willing to join forces with other companies are likely to experience improvements in both profits and productivity if they approach partnerships properly. Instead of fighting the competition, smart businesses are partnering with complementary ventures to pursue larger jobs, share referrals and swap industry news. The result? More work for all.



Test the Waters

Copacabana Design USA, Inc. (www.copacabanausa.com) in Santa Clara, Calif. provides its corporate clients with print design, web design and full-service printing services through its Copaprint division (www.copaprint.net). A few years ago, Jason Saldana, president of Copacabana Design, began testing hand delivery of its clients' marketing materials through A&A Distribution, Inc. (www.aadistributioninc.com). The arrangement worked well and Copacabana began sending A&A a lot of business. So much business, in fact, that Saldana proposed a more formal alliance to benefit them both.

"The right alliance can take your business to the next level"

Starting slowly, Copacabana began offering A&A Distribution's services to its clients and they returned the favor, offering its clients design and printing provided by Copacabana. This year business at Copacabana Design is up 30% and revenue is up 60% already, thanks to their expanded service offerings and client base. "We're getting more work from existing customers as well as work from new customers, so much so we have had to hire more support staff, which in turn, has created viable jobs for our economy," says Saldana.

Prequalify Associates

"It's easy to find complementary services," cautions Saldana, but not as easy to trust. And yet trust is critical to any alliance or partnership. The amount of information potential partners are willing to share about what they're best at, which services are most profitable, what their challenges are and how you may be able to work together can be used to gauge how successful the alliance may be. The more they open up, the less your chances of failure, says Jason Cormier, co-founder of Room 214, Inc. (www.room214.com), a social media agency in Boulder, Colo.

Share the Wealth

Companies that benefit most from partnerships with other businesses generally take a "how can we all benefit" approach to the alliance. Focusing too heavily on how your business will benefit, trying to quantify how many referrals you may garner and how you can tap into your partners' resources is likely to result in resentment and failure, observes Cormier. Conversely, "when both sales teams are operating in a way that is advantageous to both companies, everyone wins," he says.

One of Room 214's first partners was a New York City-based public relations firm, which referred the company to one of its clients, The Travel Channel, which is now Room 214's largest client. In addition to taking good care of their mutual client, Cormier and his team have also worked hard to repay that trust and referral. "That's a life-long relationship," he says with gratitude.

Attitude of Abundance

For some business owners, recognizing that there is a greater upside to being a partner is a leap that needs to occur, Cormier says. Rather than being afraid of sharing your secrets with a firm you may view as your competition, understand that there really is enough business to go around.

"The right alliance can take your business to the next level," says Cormier, whose company is on a fast-growth track thanks to its seven partners.

For more tips on running your small business and how Comcast Business Class can help,visit **www.business.comcast.com.**

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Speed Dial

Making Banks Lend



Elizabeth Warren, the congressional TARP watchdog, says there's no evidence the $700 billion bailout boosted lending to small business

You report that after Treasury infused capital into banks, most recipients decreased their small business lending rather than increasing it. Why?
Wall Street banks cut back small business lending by 9 percent, more than double their 4 percent cutback in overall lending. Small business lending is expensive. It falls between consumer lending, which is driven almost entirely by numbers like credit scores or Zip Codes and pays off in volume, and large business lending, which is very much about relationships but pays off in very large fees per transaction. Small business lending has proportionally more expense associated with each loan.

Treasury is proposing a measure to provide smaller banks with $30 billion to get them to lend more to small companies. Will this do more to increase credit than the Troubled Asset Relief Program did?
What the Secretary of the Treasury now proposes is not a TARP program. It would require new authorization from Congress. But it continues to follow the same basic TARP pattern: Put money into banks, and they will lend it. The legislation would add some incentives to make the borrowed money cheaper if it's loaned to small businesses, but it's not clear that those incentives will be strong enough.

Even if small banks do start lending more, can they make up for the contraction by the largest banks?
Our economy increasingly must rely on small banks to fund small businesses, but many of those same small banks are themselves in trouble. Commercial real estate loans have left huge holes in the balance sheets of many of these banks, and there's more trouble on the horizon. Frankly, I'm worried.

Some banks argue that lending is constricted because regulators are pressing them to reduce the risk on their books. Do you agree?
Banks have to show that they're strong, and if they're not strong, then the regulators are right to press them to reduce risk. Banks complain about their regulators, but the banks are not going to get structurally stronger from looser regulations. Right now there are no data that suggest the regulators are too tough.

You say Treasury doesn't have good data on small business lending.
The data were terrible even before the crisis—very little information was collected. TARP presented an opportunity to require much more granular reporting from the banks that took taxpayer money, but Treasury didn't ask for it. We pointed this out early and often, but no changes were made. Now, policymakers are flying blind because they failed to collect data on many aspects of how lending shifted when the financial crisis hit. B —*John Tozzi*

Finance

Yet Another Blow to Small Business Credit

▸ Suppliers are increasing scrutiny and cutting off risky customers

▸ A lumberyard chooses "not to be a bank for builders"

With revenues at his six-employee construction business on track to jump 10 percent this year, to $2 million, Gary Desilets thought he'd be able to get credit pretty easily. As it turns out, securing financing is harder than he expected because his trade creditors—suppliers that let companies buy now and pay later—have been scrutinizing his Bristow (Va.) business more closely. In April the company that sells him concrete, lumber, and other building materials slashed his credit line from $200,000 to $20,000, and **Home Depot** cut him to $8,000 from $20,000. "Our mistake was believing the hype about not worrying about your debt as long as you can service it," Desilets says. "That's a bunch of hooey unless you're a big company with a lot of resources."

Only about 20 percent of the short-term credit for small businesses comes from banks. Suppliers make up most of the rest, according to the Credit Research Foundation, a trade group in Columbia, Md. Now with banks choking off credit, many small companies are pressing vendors for more time to pay their bills, in effect asking for a loan to tide them over until they get paid by their clients. "Small businesses have been forced to reach out to trade creditors and begin to utilize them as bankers," says Lyle P. Wallis, vice-president of the Credit Research Foundation.

To make sure they don't get stiffed, trade creditors are taking a closer look at customers that ask for credit. They are using sophisticated risk analysis to ferret out and cut off customers who are least likely to pay their bills. Wallis estimates that over the past 18 months trade creditors have doubled their use of scoring tools such as credit reports from **Dun & Bradstreet** and **Experian**. **Predictive-Metrics**, a firm that advises trade creditors on risk, has seen client in-

NIGEL PARRY/CPI

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quiries triple over the past three years.

It used to be that business owners who were late on small debts could work out a deal with suppliers, but the analytical tools leave less wiggle room. A plumber working on new commercial construction that may never be completed might now be categorized as a higher risk than a repair plumber who does small jobs in existing homes and is more likely to be paid by his clients. "We [now] get personal guarantees from the business owner, all partners, and all partners' wives," says Terry Michnya of **Barrons**, the building supply store that cut Desilets' credit line. It requires a payment pledge from any customer that goes 30 days past due on an account. "We choose not to be a bank for builders," says Michnya.

Few trade creditors are willing to cut off buyers entirely because they fear their customers would simply stop coming. "Trade creditors have to step in or they lose the sale," says Rob Olsen, chief risk officer at **Wright Express Financial Services**, a Salt Lake City firm that provides payment processing for truckers and other small businesses across the U.S. Still, he says, they're far more careful about assessing the risks. "They know their customers better than they did in the past." —*Nick Leiber*

***The bottom line** Trade creditors are starting to pay more attention to their small business accounts, further tightening credit.*

Lending

Microfinance Steps Into The Funding Breach

- Rejected by banks, small business turns to nontraditional lenders
- "People get that we have to rebuild the economy in a sustainable way"



Ortiz-Cartagena got $60,000 from a microlender

Gentle Parking has grown quickly since William Ortiz-Cartagena started the San Francisco company two years ago. He now employs 25 people and says he turns a decent profit running six parking lots, including two he manages for the city. When he decided to bid on a contract to run another city-owned lot, though, two banks turned down his application, citing problems with his home mortgage. Ortiz-Cartagena turned to **Opportunity Fund**, a Bay Area microlender that had loaned him $10,000 to start his company. He soon got a $60,000 line of credit at 8 percent interest. "For a small business to get a city parking contract is unusual ... because smaller companies can't carry the cost of insurance," he says. "It's like David and Goliath, and Opportunity Fund is my slingshot."

Microfinance lenders, originally geared to helping the disenfranchised, are providing more financing to small businesses that can't get bank loans. While microfinance represents a tiny fraction of the U.S. credit market, it's growing fast. The industry group Opportunity Finance Network says 56 percent of microfinance organizations last year saw increases in loan applications. Most likely to get funding were "people who were very strong small business owners who in the past would have received financing [from banks]," says Elaine Edgcomb, who studies microfinance at the Aspen Institute.

Domestic microfinance groups loaned $57 million in 2008 (the most recent data available), up 68% from a previous survey in 2002, according to the institute. The U.S. groups are typically supported by government agencies and nonprofits, and about 400 of them offer small business loans that average nearly $9,000 and are usually capped at about $35,000.

The industry received attention two years ago when Grameen America, an offshoot of Bangladesh-based **Grameen Bank** founded by Nobel Peace Prize winner Muhammad Yunus, opened in New York. Among the biggest U.S. microlenders is Opportunity Fund, which financed Gentle Parking. It is on track to make 200 loans this year, up 30 percent from 2009, says Chief Executive Officer Eric Weaver. "People get that we have to rebuild the economy in a sustainable way," he says. "Microlending fits right into that."

Even relatively tiny amounts of cash can make a big difference to a small company. Simonida Cvejic left her native Yugoslavia when war broke out, won grants to study abroad, and worked for **Goldman Sachs** in Silicon Valley before starting a school for medical technicians in 2005. By 2007 her **Bay Area Medical Academy** had grown to $500,000 in revenues. Yet when Cvejic applied for a $10,000 bank loan to lease and furnish more classrooms, neither her scrappy background nor her successful business was enough to win over traditional banks. Opportunity Fund loaned her $10,000. That helped her attract $20,000 from a private investor, and today her company brings in $1 million in annual revenue. "A lot of my business growth was based on my own revenue, but there are times when you need a capital injection," Cvejic says. "Opportunity Fund came in at a crucial point." —*Karen E. Klein*

***The bottom line** As banks have been slow to boost credit for small business, microfinance groups have stepped up lending to entrepreneurs.*

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Sharon Vosmek

Focus On Enterprise

Women Entrepreneurs Still Struggle to Get Funded

Back in 2006, Alexa von Tobel had what she considered a sure-fire business idea: A website with investment tools and advice columns to teach young women about personal finance. It took nearly three years for her to round up her first external funding, $1.1 million from angel investors. In April, after eight more months and 35 investor meetings, she obtained $4.5 million from Silicon Valley venture capital firm **Accel Partners**.

It's too early to know if her company, **LearnVest**, will change the world as von Tobel predicts. Yet even after von Tobel's arduous quest for financing, the 17-employee operation has already beaten the odds. Over the past decade companies headed by women represented less than 7 percent of the startups funded by venture capital firms, even though women launch nearly half of all new businesses.

To address this problem, former **Cisco Systems** marketing executive Catherine Muther in 1999 founded the Women's Technology Cluster (later rechristened Astia, a name derived from the Greek word for star). The group was created to help companies run by women that need outside capital. At the time, less than 2 percent of the businesses funded by venture capital firms were headed by women. While that percentage jumped for a few years, it had fallen back to just 3 percent when I took over as Astia's chief executive in 2007.

Since 2003, Astia has connected LearnVest and 225 other startups founded by women with investors and other entrepreneurs, who offer contacts and coaching. Within a year of joining our program more than 60 percent of them have gotten financing, had an initial public offering, or were sold.

I'm proud of that record, but I have to admit Astia has had less success in bringing about deeper change.



Vosmek wants to spark a movement

We have focused on solving problems for one company at a time as opposed to generating broader venture support for companies founded by women. We have failed to develop a common strategy with other organizations pursuing similar goals. In short, we have failed to create a movement.

We're now developing a more collaborative approach to the problem, asking investors, entrepreneurs, and industry leaders what they would do to help women achieve success. On Jun. 8 we and the Kauffman Foundation held the "We Own It Summit" in New York. The daylong event included investors, academics, policymakers, and two dozen U.S. and European nonprofits such as the Anita Borg Institute (which aims to foster women technology leaders) and 85 Broads (a networking group).

Women launch nearly half of all startups, yet they lead only 7 percent of companies backed by venture capital

What we learned contradicted some long-held assumptions. For instance, we believed women are often older than men when they start their first company and thus have different motivations, such as a greater work-life balance. Yet Kauffman research shows that successful entrepreneurs running high-growth businesses are similar in almost every respect. Male or female, entrepreneurs have largely the same education, economic background, needs, and challenges. Women, though, are better at building relationships and place greater importance on the moral support, expertise, and financial backing of business partners, while men need far less encouragement from others.

We're now drawing up plans sparked by what we learned at the summit. We aim to compile better data on women's participation in business, including an annual census of female-led startups and patents filed by women. We expect to conduct more research on the performance of companies started by women and assess the impact of social networking on women entrepreneurs. We believe such projects can help increase the number of women investors, entrepreneurs, and board members and boost their overall success.

Why do we care so much about the future of women in business? There is a robust body of research demonstrating women's impact on job creation and economic growth. One Babson College study I find particularly compelling in today's recessionary climate shows that if female entrepreneurs started with the same capital as their male counterparts, they would add 6 million jobs to the economy in five years–2 million in the first year alone. How's that for an economic recovery? **B**

Vosmek is CEO of Astia, a nonprofit that helps startups headed by women.

PHOTOGRAPH BY [illegible] BLOOMBERG BUSINESSWEEK

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Life Amid The Ruins

An economic collapse, the biggest bailout in EU history, and sweeping government reforms have shocked Greece. A special report on the country's new misery—and opportunity. By Suzy Hansen. Photographs by Antonin Kratochvil

A couple of months ago, around the time Greece passed new austerity measures to ward off economic catastrophe, Nicholas Papandreou, the very tall brother of Greece's Prime Minister, George Papandreou, was riding the Metro in Athens. The Papandreous, now in the third generation of a Socialist political dynasty, live in rented houses, drive Priuses, and, apparently, take the subway, even during times of extraordinary anger toward the government.

"Nick! Why did your brother bring in the IMF?" one passenger called out.

"No choice. It was either that or no one gets paid come July 1st," Papandreou, an economist and novelist, replied.

"Well, I am glad to see you taking public transport," the passenger said, prompting another rider to pipe in, "I always see Nick on the Metro!"

"Excuse me, but what do you do for a living?" Papandreou asked the first man.

"I'm a doctor."

"Did you ever take side money from your patients?"

Everybody was listening. "Yes."

"Are you still taking money on the side?"

"Not anymore."

"Why?"

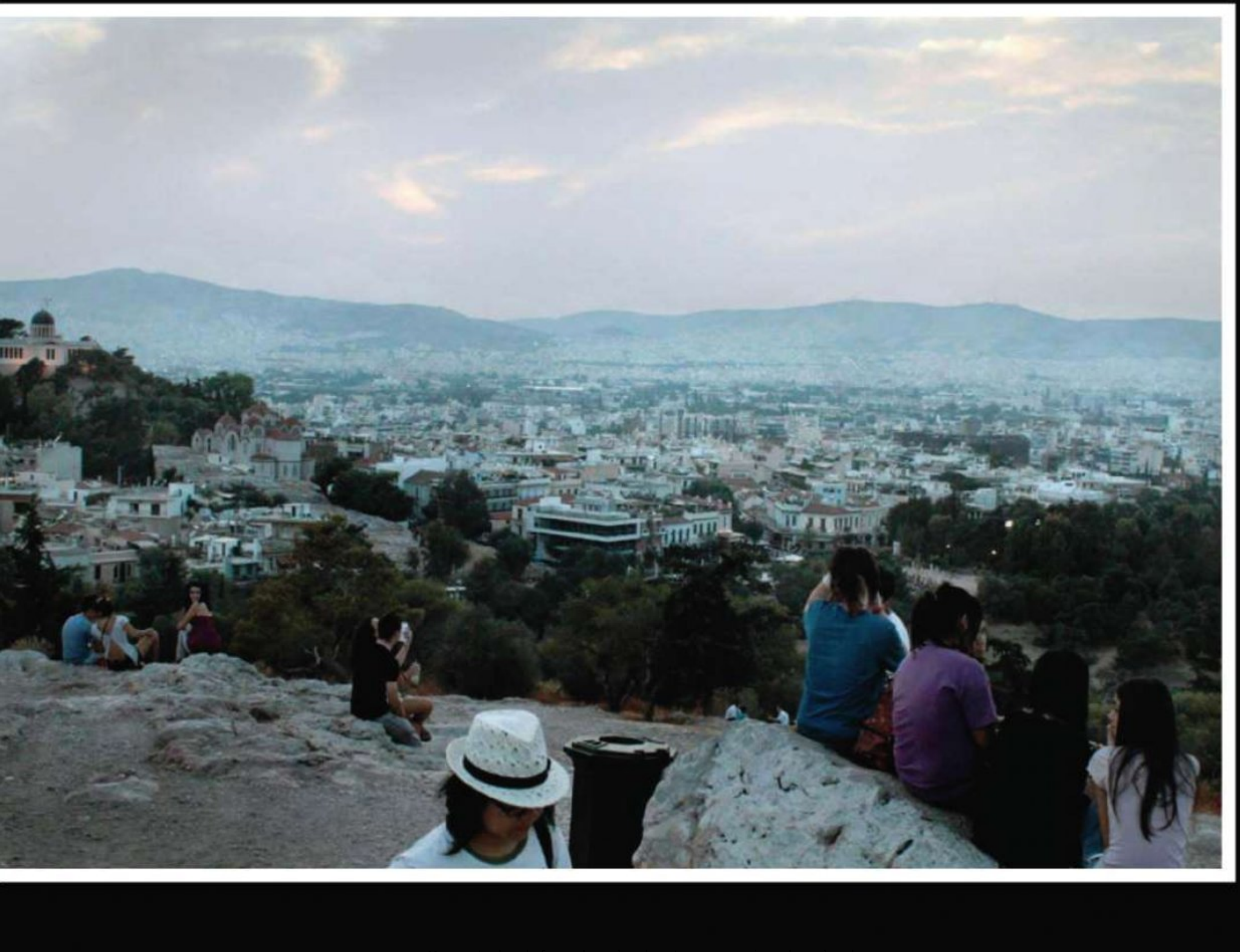
"Because now, the way things are, I'd be lynched."

"See?" Papandreou said. "That's one good thing George has done so far."

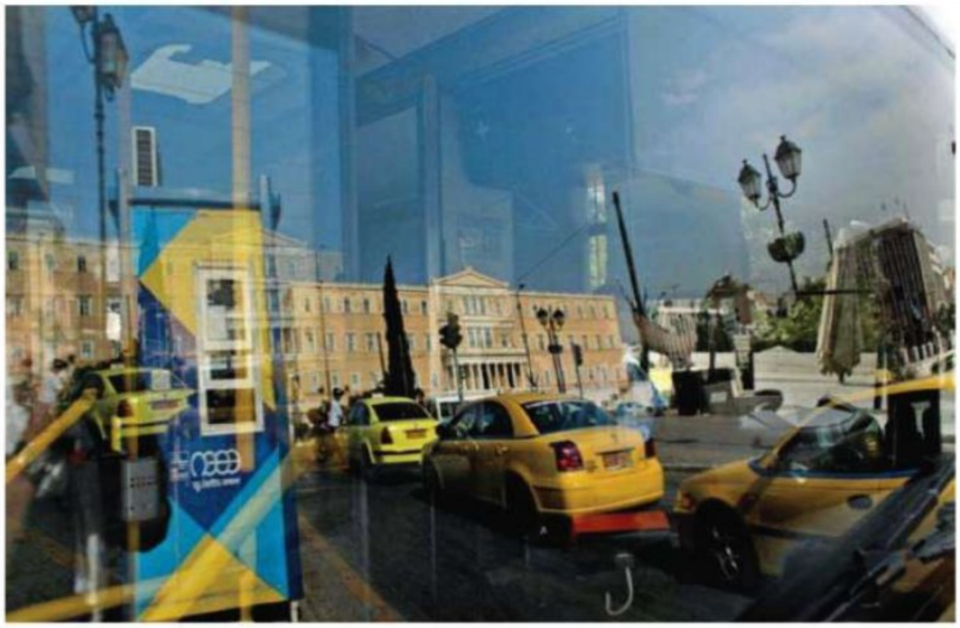
Papandreou tells this story while sitting at a long table at the Andreas G. Papandreou Foundation, a beautiful old house in a slightly run-down part of Athens. A terrace off the back overlooks the city's ancient graveyard. Family photos hang on one wall; Nicholas' books and pamphlets about his father, Andreas, line the other. Papandreou, who grew up in Canada and the U.S., sounds American. He portrays his efforts to help out during the crisis as something any member of a family business would do. Indeed, the past few months have seemed like an all-hands-on-deck situation: Nick the Novelist Brother is not only placating doctors on the Metro but was taking off to Qatar to try to secure foreign investment for his country.

That the intimidation of medical professionals counts as a positive development might indicate just how dysfunctional Greek society has become. It also shows that the Papandreou government's attempts to reform Greece will require nothing less than a societal revolution, affecting everyone from cab drivers who don't give receipts, to tax collectors who bribe lawyers, to college kids who dream of nothing more than a good, solid pension. Greece's "shadow economy," estimated at 20 percent to 30 percent of the country's gross domestic product, depends on the wonderfully named *fakelaki*–also known as "little envelopes" or "bribes." (In general, reliable economic data for Greece can be difficult to find.) It's part of a state of affairs that includes a bloated public sector and a stunted private one, both legacies of a political system prone to patronage and corruption.

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Athens' Parliament building in Syntagma Square is the site of regular protests

The cruel result amounts to 300 billion euros in debt—115 percent of the country's GDP or about $27,000 per Greek citizen. The 110-billion-euro bailout from the European Union and the International Monetary Fund includes strict austerity measures intended to shrink the budget deficit from 13.6 percent of GDP to 3 percent in three years. The prospect of that has thrown Greece into chaos.

The Greek people are angry. While young anarchists wielding Molotov cocktails are getting most of the attention, there are far greater numbers of Greeks stewing in their tiny apartments, furious with their leader for capitulating to the markets and the IMF and for saddling the Greek people with a life-changing burden. Experts and average Greeks alike told me that Prime Minister Papandreou and Finance Minister George Papaconstantinou must do things to rescue their country's finances that would normally be tantamount to political suicide.

"They're already dead," says the former Finance Minister, onetime member of the opposition New Democracy Party, and free-market crusader Stefanos Manos, speaking of the government's austerity measures. "They can't die twice. Why not do the right thing?"

Greece is a Teenager

When I first arrived in Athens in May, expecting to see rampaging youths attacking policemen, I marveled at the apparent prosperity and pleasantness of everyday life. The Metro even has one of those fare systems based on trust—like Switzerland! It wasn't long before darker sentiments became palpable. The Greek capital these days exists in a state of shock, suspicion, and bewilderment, not unlike the way New York felt in the fall of 2008 after Lehman Brothers collapsed—a sense that strange forces had created financial scenarios no one could yet understand. Something has gone terribly wrong with the system. For the little nations on the edges of the so-called first world, market-happy modernity can be harder to keep up with and easier to turn against during difficult times. In Greece, the past few months have been a brutal conclusion to what had been a glorious party of admission to Western consumer capitalism.

"The best way to think of it is to think of Greece as a teenager," says Stathis N. Kalyvas, a Yale University political scientist who was in Athens when I visited. "Many Greeks view the state with a combination of a sense of entitlement, mistrust, and dislike similar to that of teenagers vis-à-vis their parents. They expect to be funded without contributing; they often act irresponsibly without care about consequences and expect to be bailed out by the state—but that only increases their sense of dependency, which only increases their feeling of dislike for the state. And, of course, they refuse to grow up. But like every teenager, they will."

The story of Greece recalls a familiar old world/new world tale: a poor country 30 years removed from a devastating communist-royalist civil war and five years from a fascist military dictatorship finds itself, in 1981, in the maternal embrace of European Union membership, flush with all the easy funds that follow. Two decades later come the success of the 2004 Olympics, the arrival of Dolce & Gabbana, the proliferation of credit cards, and an airport as polished as a museum. Life, on the surface, looks good— though the old, unhealthy habits continue: public-sector employment for life, politicians with stuffed pockets, an aversion to foreign investment, snail-like growth, communal life that keeps people happy at the taverna table but stifles individual creativity, a sense that beating the "system" is what the smart people do.

What happened next took an unexpected, Don DeLillo-esque twist: Men in New York and London devise new games to play with the world's money. The world falls into recession. In Greece, the economy sputters, the ruling political party refuses to reduce spending before the 2009 election, and the old habits become harder to conceal—more so because the then-ruling party consisted of, as the young Greek novelist Constantine Abazis puts it, a bunch of "morons." And like the wife of an alcoholic who willfully disregards the vodka bottle stashed in the closet, the EU looks the other way. "Greece has a very cosmopolitan, international elite, and at the same time a rapidly deteriorating quality of the political class," says Loukas Tsoukalis, president of the Athens-based think tank ELIAMEP. "In recent years a number of [European] Commission officials knew that the fiscal situation in Greece was worse than portrayed. The surveillance system has clearly failed."

Nicholas Papandreou at the Andreas Papandreou Foundation in Athens



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Stereotypes of Greek people as lazy and sun-stroked may have roots in the public sector: For decades politicians plied poor citizens with cushy jobs and pensions in exchange for votes. The 2004-09 conservative New Democracy government added over 85,000 public-sector jobs in its tenure; the public sector accounts for 40 percent of Greece's GDP and 15 percent of the active workforce. The government isn't even sure how many people it employs. As Jens Bastian, an ELIAMEP economist, explains, "Every Greek has a relative who works as a civil servant in the public sector, excluding the military and police. Reducing employment levels in the public sector immediately becomes a very touchy, family affair."

The Greek crisis reminds us that while Greece is a part of Western Europe, it is also a place where hammers and sickles and "F--- the Police" decorate the city walls; where references to civil wars and world wars and postwar American meddling come up in daily conversation; where immigrants fleeing violence and economic plunder scramble atop the life raft of Greece's fragile European shores, only to fester in homogenous Athens. It is also a country that in some ways still mirrors the lands across the Mediterranean—the countries of North Africa and the Middle East that continue to be strangled by Third World ways and won't simply acclimate to the rules of the West as one might have hoped.

Reform and Punishment

If the Greeks have one thing going for them, it's a deep, proud sense of their country's beauty. Everywhere I went, the average Greek would complain about this or that, and then mention the islands or the countryside, shrug, smile, and say: "But, you know, it's a beautiful country."

"You know, I think these people in America, they are jealous. Because ... we have such a beautiful country."

"Everything here is s---. But it's a beautiful, beautiful country."

On May 20—a beautiful day in the beautiful country's semi-beautiful capital—Greeks launched another general strike and protest. It fizzled. During the previous week's protests, the branch office of a bank in central Athens was firebombed. Three employees, including a pregnant woman, had died of smoke inhalation. More recent protests have been less destructive, perhaps because of the overwhelming presence of riot police with their shields, billy clubs, tear-gas guns, and nine-millimeter pistols. The police closely tracked the clusters of anarchists, who bore the international uniform of the 21st century's petulant warrior class: black hoodies and boots, backpacks, pale skin, skittish, overloud laughter. The rest of the protesters looked rather upscale as they walked slowly and patiently to the head of Syntagma Square, where the lovely yellow Parliament building overlooks the area from a hill. At sunset, in that truly celestial Athens light, the rest of the square would be in shadow, but the Parliament building glowed. This was where the energetic protesters of Athens spent their days, shaking their fists and trying to break down the doors.

The past few months have been a brutal conclusion to a glorious party of admission to Western consumer capitalism

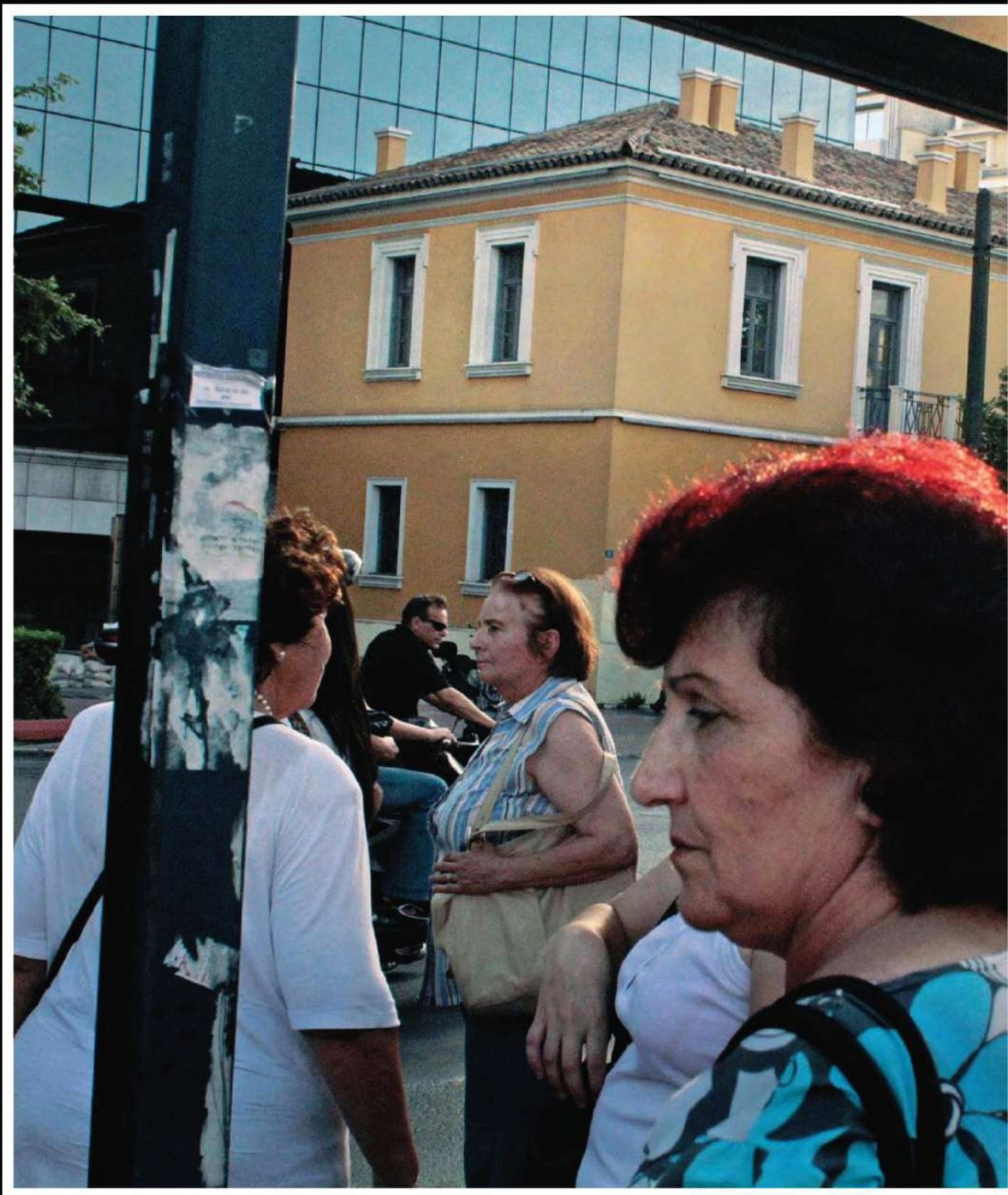
Greeks believe in protest. During a week in Greece, I witnessed four demonstrations, including one rather elegant march through the fancy neighborhood of Kolonaki, the protesters mourning crimes by the Turks in the Black Sea in 1922. Tourism employees protested at the Parthenon; others went on strike at the docks in Piraeus. This was normal. Since the military dictatorship, the leftist ideological consensus has required that Greek people generally ignore, if not tolerate or condone, a certain level of dissident violence in addition to agitation. But that day, the mood among protesters was weary, almost defeated.

After the Greek government accepted the IMF bailout, officials began to impose not only reforms but punishments. Pension plans and wages were cut by 15 percent to 20 percent. Value-added and excise taxes were raised twice. Bank accounts were opened up, and names were named: Those 57 doctors who didn't pay taxes, for example, were identified to the public. Tax-collection directors were replaced, employees were shuffled to new posts, bribery complaints were investigated. Even some 16,000 rich Athenians who dwell in the magnificent northern neighborhoods of the city found themselves targeted for failing to disclose that they own swimming pools on their tax returns. (It's estimated that a third of economic activity produces no tax revenue whatsoever, an annual tax shortfall of approximately 25 billion euros a year.) The Minister of Tourism resigned after it was revealed that her husband, a beloved pop star, owed millions in back taxes. Bastian, the economist at ELIAMEP, told me that, for the first time, a Greek government was cracking down on a way of life.

The Greek Academy in Athens: For the first time, the government is cracking down on a way of life



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It had no choice. But to get the people to change–quickly–the politicians needed to make sacrifices, too. The Finance Ministry made it clear the crackdown would extend to government officials: "According to a preliminary investigation, 70 Finance Ministry employees have real estate holdings ranging from €800,000 to €3 million in value. The average real estate holdings for these employees is valued at €1,228,337, while their average declared income is €50,834. The Finance Ministry is launching investigations into all these cases," although it will have to do much more than that.

Greeks reacted to questions about how the country ended up with so much debt with almost comic confusion. "I was also asking myself this: What were they doing?" says Michalis Chrysochoidis, the Minister of Citizen's Protection. He mentions former Prime Minister Kostas Karamanlis. "[He] created a utopia, an illusion that we can live well without trying to make things better." Many observers described Karamanlis, who was elected in 2004 on an anticorruption platform, as an easygoing manager who didn't control his cabinet. Then in 2008 and 2009, when the New Democracy party had to run for reelection, the administration completely stopped trying to reduce spending. "The deficit was initially projected at less than 4 percent, and it turned out to be 13.6 percent," ELIAMEP's Tsoukalis says. "Under normal circumstances it might not have been the end of the world. But it happened at a time when everyone had realized that sovereign debt had become the big issue. Faced with the prospect of the 2009 election, the previous government showed negligence. They just let it go."

This partly explains why anti-corporate sentiment is not among the grievances widely aired in Greece. Resentment is reserved not for the rich but for the government. Greek banks didn't engage in reckless financial schemes the way American banks did, showering easy credit on people who couldn't afford to pay it back. It was the government that did most of the borrowing. "Everywhere else in the world the banks brought down the economy and pressured the government," says Gikas Hardouvelis, chief economist at Eurobank. "Here the state finances are pushing down the banks."

I told Hardouvelis a story I had heard about a Greek entrepreneur who couldn't persuade foreign investors to trust Greek banks as his backers anymore.

"Investors feel that if the country defaults, Greek banks will be in trouble," he says. "Still, the exposure to Greek bonds is low. Greek bonds are not owned by domestic banks. They're mostly owned by foreign banks." Which is why fear of contagion is so intense.

"That's a big issue, certainly," says Jon Levy, Europe analyst at the political risk consulting firm Eurasia Group. "But there are multiple channels of contagion." For example, contraction in countries that need to cut expenditures would also affect other European countries. A drop in demand in Spain would mean a drop in demand for German cars, triggering declining incomes in Germany and leading to a contraction there. "These channels of contagion are really just beginning to become evident," Levy says.

A Job for Life

Hardouvelis, the Eurobank economist, served in the 1996-2004 government of PASOK, under Prime Minister Costas Simitis, who was a promising leader until his government dissolved in a storm of scandals. Simitis had presided over a period of transformation that coincided with a high point in recent Greek economic history: 2004, the year of the Olympics. In readying itself for the international extravaganza, the nation spent money like a working-class bride on her country club wedding, thinking it the most important day of her life.

"Greece was an under-banked economy for a long time," Hardouvelis says. "Mortgages and consumer loans were effectively prohibited until 1993. When that changed, together with growth, credit expenditures grew faster than nominal economic activity. But as long as there was growth, no one worried." In 2004, Greek GDP growth was a strong 4.6 percent, mainly fueled by the Olympics construction boom. The Games inspired immense pride for the Greeks and served as a coming-out party of sorts, an emblem of security and wealth. "The facilities were maharaja-level luxury," says Stefanos Manos, the former Finance Minister. "Greece had the mentality of the nouveau riche. We borrowed, and we spent." The nation hungered for new status symbols. A 2008 Nielsen report found that, of all the countries in the world, Greece cared most about designer labels, trampling Hong Kong (the runner-up) in its taste for brand names.

Ayis Georgoudas, chairman of Nak, a collection of shoe stores and international label outposts, rode this materialist wave. When I met him at his office at a Bally store, it was a Saturday and he was working. Three young women

"Greece had the mentality of the nouveau riche. We borrowed, and we spent."
—former Finance Minister Stefanos Manos

were helping a wealthy couple trying on shoes that, at Bally, can cost as much as 300 euros. Upstairs in his small office, Georgoudas, 35, had a collage of photos and clippings on the wall: Dostoyevsky and Solzhenitsyn; Michelle and Barack Obama; Jesus Christ.

Georgoudas wore green high-top sneakers with black laces and a white monogrammed button-down shirt. He is from Thessaloniki, in Greece's north, where he worked in his family's shoe stores as a kid. His family did well enough to send him to New York University, where he received bachelor's and master's degrees. Within the past five years he expanded the family business to 20 international brand chains, introducing Bally, Clarks, Naturalizer, and others, to Athens, bringing in 20 million euros a year in sales. "Some private-sector employees feel bitter about their counterparts in the public sector," Georgoudas says. But, he explains, "I just love to work."

A 2008 Nielsen report found that, of all the countries in the world, Greece cared most about designer labels



Stefanos Manos applauds the recent decisions to cut wages and raise taxes but believes more drastic measures are needed. “The average pay is two and a half times the pay in the private sector,” he says. In his view, more must be done to create a competitive environment. “In Greece, you cannot rent a little truck to move your refrigerator,” Manos says. “Why? To protect the truckers. You have to hire a trucker. You have to get a parking permit. If you sell your house, both parties have to have a lawyer–by law–to participate in the transaction, and they’re guaranteed a percentage of it. If I want to give my house to my son, both he and I have to have lawyers. If Coca-Cola wants to take out an advertisement during a news program on TV, a percentage of it [20 percent] goes toward a pension fund for journalists. They have so much money in there that journalists don’t even know or care how much money they have!”

Then there are the bribes. “Lawyers know that when a tax collector comes, he will ask for a bribe. Doctors, too. But that tax collector has a job for life. A surgeon at the state hospital expects something on the side,” Manos says. “Otherwise, you can get your operation in six months or more.”

The Oedipus Complex

If ancient Greece is known for Zeus, democracy, and civilization, modern Greece claims Aristotle Onassis and the islands, which is to say, shipping and tourism. The two account for more than a quarter of the country’s economy. So far, only one has been affected by the crisis. In June, hotels reported a 30 percent drop in sales, though you wouldn’t know it from the number of tourists craning their necks from the Plaka up toward the Acropolis. Hoteliers complained that the overplaying of riots on television had scared off travelers who didn’t know that civil unrest in one neighborhood would hardly affect the frappe-drinking café conviviality of the next. The Acropolis and its hill of ancient treasures hover literally above the fray.

There were murmurs of labor strikes at island ports, which Nicos Vernicos, a shipping magnate and president of the International Chamber of Commerce, passionately decried. I interviewed Vernicos across a divan at his luxurious, art-filled home in the waterfront suburb of Glyfada. The house radiated a quirky, restrained air that almost smelled of old money; Vernicos Shipping Group is one of the longest-serving members of a tiny, private club that seems to operate in its own little maritime universe.

Although Greeks don’t do much exporting, they do ferry around 15 percent of global goods. So the shipping companies are far less vulnerable to the internal dynamics of the Greek economy than they are to, say, trade between China and all of Europe. Unfortunately for the Greeks, the very thing that keeps the shipping industry based there, as in many countries, is that it does not pay corporate tax. Ship owners pay taxes based on tonnage but not on actual shipping, providing little revenue for the Greek state. That’s because 50 years ago, Greece passed something called Law 89, a massive tax break for ship owners in exchange for pumping money into the economy, according to Clay Maitland, a managing partner of the Marshall Islands ship registry. The deal still provides Greece with a lot of jobs, something it can’t afford to lose. “It’s kind of like the financial industry in New York,” Maitland says. “[The shippers] can move.”

Manos agrees. “You push them and they’ll simply hoist a different flag and move out,” he says. “They have an escape clause. Because of this clause, governments have been mostly reasonable.”

When I ask Vernicos about the tax issue, he says: “Greek shippers are much-above-average patriots, and they support their country.” Later, he proudly displays his collection of Hellenic-themed art, including an Andy Warhol of Alexander the Great.

Vernicos’ business dates to the mid-19th century, when his family rowed goods across the Bosphorus in Constantinople. His father served as a member of the pre-junta Parliament, and the young Vernicos spent time in jail for activities against the military dictatorship. After the turmoil of the 1970s, he settled down to navigate the rocky seas of the country’s fledgling democracy, as well as something unexpected: the European Union.

“Papandreou knows better than all of us the weaknesses of his father.”
— Nicos Vernicos, head of Vernicos Shipping Group



Vernicos at the Grande Bretagne Hotel in Athens

When Greece joined the European Community in 1981 it was embroiled in conflict with Turkey, an issue that still motivates Greece to spend billions on its military. Greece was admitted to the EU largely because of the credibility of the Prime Minister at the time, Konstantinos Karamanlis (the father of former PM Kostas), and Europeans’ attraction to all things old and Greek. Karamanlis was soon replaced by Andreas Papandreou (the son of George and the father of the current George), who campaigned on anti-NATO, anti-EU, and anti-American populism, even though he had an American wife.

“People familiar with him knew he didn’t mean it,” ELIAMEP’s Tsoukalis says. “But the adjustment was not always painless.” At the time, Papandreou *père* had to reunite a fractured country, so with generous socialist policies he won support from the lower classes and the countryside. “He brought new people into the Greek political scene, he gave marginalized people their rights. But redistribution was done at the expense of future generations.” He also kicked off the addiction to pension plans, many of which went to civil war veterans–something staunchly defended by at least one of my ranting, receipt-hating taxi drivers.

“The crisis did not happen overnight. We’ve been overspending for the last 25 years,” says Manos. “It was accepted political wisdom that if you gave out jobs for life, this would guarantee the votes of entire families. I think it turned out to be correct.”

The father-son conflict at the heart of the Greek political crisis makes sense in a country dominated by family dynasties. Papandreou the son (page 61), who is bookish and quiet, now must clean up the mess made by Papandreou the father, who is flamboyant and charismatic–or so the story goes. “Like most children, Papandreou wants to avoid the negative aspects of his parents,” Verni-

cos says. "He knows better than all of us the weaknesses of his father and wants to be different."

Even so, the PASOK government was slow to recognize just how bad the situation was. "Everything changed after Davos," Vernicos says, referring to last winter's Davos Economic Forum. "When the bankers and politicians meet each other in Davos, you have Bill Clinton and Bill Gates wearing ski anoraks, and they all speak the truth," he says. "After Papandreou went in February, he realized the scale of the danger. He changed completely after he came back from Davos."

"Who is educating the Greek government and the Greek people and European leaders?" Vernicos continues. "The markets. If you see what Euro leaders were saying a few months ago and now, there's a world of difference in [German Chancellor Angela] Merkel and the others. The markets are the harshest tutors."

Suddenly, the good socialists of PASOK must transform themselves. While I was in Athens, the party was courting a Chinese shipping company, Cosco, which made a deal to take control of Athens' main container dock in its Piraeus port and was eyeing land for a logistics center in an environmentally beleaguered area called Thriasio. Although the labor class regarded Cosco as a threat, the political elite rejoiced; even Greek socialists are pouring ouzo for the smiling Chinese communist-capitalists.

"All these guys are now running after Mr. Cosco," Vernicos says. "They're having to lick where they spat." But he is optimistic. "For the first time we have a team managing Greece that doesn't care about political gain, they just want to do the best for their country," he says. "They really don't care about being reelected."

The Human Strain

For all the hardship visited upon Greece, extreme poverty keeps a low profile in Athens. In recent decades the country has seen an influx of Albanian workers who more or less look Greek and work very hard. They speak the language and have secured a place in society. But the hundreds of thousands of other immigrants in Athens—the Africans and the Pakistanis, the Bangladeshis and the Afghans, the Kurds, the Iraqis, the Somalis, the Moroccans and the Nigerians—are different. Greece is the entry point for refugees and migrants hoping to make their way to the rest of Europe. They arrive in tiny boats, aspiring to smuggle themselves deeper into Europe. If they get caught en route, according to EU law, they can be thrown back into the dumping grounds of Greece, the first country they entered. "We are the guardians of Europe," Minister Chrysochoidis says. "This is a huge and terrible problem, a human problem. We need an independent authority of asylum, so refugees are protected and traffickers are punished. Ten percent migrants for a small country is a lot."

"What does a socialist ideology mean when you are bankrupt?"
—Loukas Tsoukalis, president of an Athens think tank

One evening, I went to see where the immigrants lived, in an area referred to as Sofokleous, which is close to the center of town. It was Sunday, and very quiet. Iason Athanasiadis, a journalist who has reported from Iran and Afghanistan, tells me to leave my handbag at home and to dress down in the hopes that we'll look like drug addicts in search of a fix.

Suddenly we turn a corner and the streets are crowded with human misery. Some people seem healthy, selling socks off the sidewalk, screaming at each other. Others are bloodied and battered, their clothes half ripped off, shoes missing. You could look to your left and see three men sticking needles into their ankles; to your right, a woman sidles up to a man for some drugs. She looks as if she has been beaten, and her flesh seems to be melting off.

We turn up a side street and spot a man inside a taverna called Klimataria, which opened in 1927. It's a happy-looking place. It's also empty. Business has dwindled 70 percent, and soon the restaurant will be moving. The immigrants sometimes attack each other in the street "with swords," according to the owner, Pericles Spiridou. Any tourists who come near the restaurant flee in fear. Only three years ago, this had been a fashionable part of town. Then the police decided to clear the main squares of several Athens neighborhoods, essentially corralling the migrants into these back streets. In a country with little industry and few jobs, there wasn't much for these foreigners to do but sell whatever they could on the street—handbags, trinkets, drugs, themselves.

Spiridou is a liberal-minded person. He doesn't disparage the immigrants. Instead, like many other Greeks, he speaks of the state. Where is the regulation? Where are the police? Forty-nine years old, with thick, wavy white hair, Spiridou also has existential concerns. "We've lived through many things," he says. "Civil war, a dictatorship, the fall of communism. Now what I hope is that I live to see the fall of capitalism. That's my dream. And I will see it." He glances toward the streets outside, where Greece is anything but beautiful.

Long, Hot Summer

Two weeks after I returned from Greece, the Finance Minister, a well-regarded figure who drives a battered Subaru, announced that the country was on track to meet its 2010 deficit targets, boasting an almost 40 percent reduction in the deficit in the year's first five months. Spending was down 10 percent; revenue was up 8 percent. He dismissed rumors of bankruptcy as "absurd" and "terror-mongering" and urged the Greek people "not to bite the bait in groundless hysteria." Bastian, the economist from ELIAMEP, describes the Finance Minister this way: "When you meet him, you feel as though, if I have to trust a politician in Greece, this is the one I trust." Prime Minister Papandreou, meanwhile, was taking to the road, courting Libyans as potential investors, a possible lifeline along with the Chinese. Rumors of a cabinet reshuffling circulated. As of May, about half of all Greeks said they supported the Papandreou government's bailout measures.

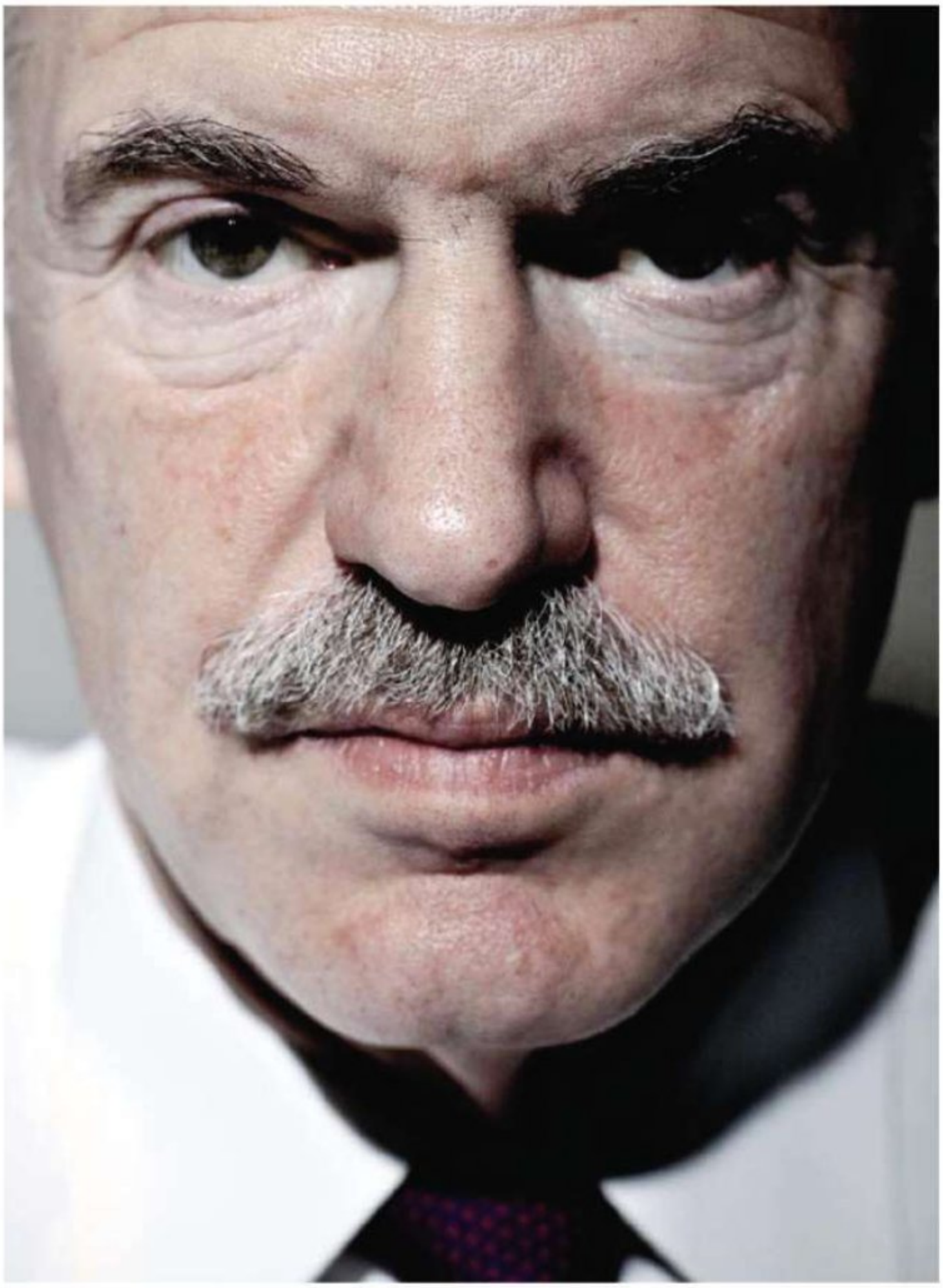
Meanwhile, bad news continues to mount. Moody's downgraded the country's debt four notches, to junk status, and private investment remains weak. The next tax increases kick in on July 1. Metro employees went on strike because 285 temporary employment contracts were not renewed.

The arrival of summer brings respite, at least insofar as escaping the feverish temperature becomes the major preoccupation and Greeks of all stripes decamp to the islands. When they return in the fall, the IMF will issue a formal progress report in advance of the next round of loans, and it will start to become clear whether there is hope for a new Greece. "Until then," says Bastian, "it will be too hot to realize what it all means." B

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The Would-Be Martyr

Greek Prime Minister George Papandreou, raised in America and steeped in the communal ethos of the 1960s, knows that his country's future depends on his getting tough and staying tough. By Alan Katz, Ashley Lutz, and Maria Petrakis


Papandreou says he's willing to risk unpopularity to make Greece solvent

As a child, the Minnesota-born Prime Minister of Greece, George Papandreou, traversed the U.S. in a station wagon with his family, bunking in roadside motels, living like a typical American. As a young man in Greece, he used his martial arts knowhow to subdue two men who had smashed an ice cream cone in an elderly man's face. As an adult, the Bob Dylan fan wooed his wife, Ada, with Greek love songs in a late-night window serenade.

These three experiences show the personal traits Papandreou is using to coax Greeks into changing how they live and achieving financial stability. Already, the scion of the Papandreou political dynasty has instituted wage cuts, agreed to hike the retirement age, and declared war on the ingrained corruption and tax dodging that have hobbled the economy. If any of it is to stick, Papandreou will need his common-man sensibility to understand the pain average Greeks are feeling, his instinct for doing the right thing to keep austerity in place, and his gift for seduction to persuade those around the world who doubt his country's seriousness.

"We saved Greece from default," Papandreou said in an interview in New York on June 20, where he was heading a meeting of the Socialist International, an organization of social democratic, socialist, and labor parties. "If we don't change Greece, we'll be back here at the edge of the precipice again some years down the road. And I think that's something people really understand."

In October, Greece disclosed that its budget deficit was likely to

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be more than four times the limit allowed under rules set up to protect the euro. In May, Papandreou clinched a rescue package totaling €110 billion ($135 billion) in loans from the European Union and the International Monetary Fund. His actions thus far have inspired some confidence around the world that all is not lost for his country. Papandreou "gives people the feeling and the trust that they can invest in helping Greece because there is somebody trustworthy," says Yossi Beilin, former Justice and Economy Minister for Israel and president of Beilink Business Foreign Affairs, who has known Papandreou for about 20 years. "He is a guy who would like to solve problems and compromises and find solutions, without compromising himself."

On June 11 in a Viennese palace decorated with frescoes depicting the deeds of Hercules, Papandreou surprised a roomful of skeptical bankers with a speech that seemed to accomplish the impossible—changing some minds about the future of Greece. Over a dinner of wild char, filet of beef, and Welschriesling wine, Papandreou promised more than 400 bankers, lawyers, and regulators that he would bring Greece through its debt crisis even if it cost him his job. When he was finished, the group rose for a standing ovation. Deutsche Bank's chief executive officer, Josef Ackermann, who last month said he doubted Greece would be able to pay back what it owes, told the room that Papandreou had convinced him otherwise.

Papandreou says losing his job for making unpopular decisions would be a small sacrifice compared with the trials endured by his father and grandfather, both Greek Prime Ministers, to keep the Mediterranean country free for democracy. His view fits a sense of public responsibility that advisers, family, and longtime friends say led Papandreou reluctantly into politics. "My father was in jail twice in his life for fighting a dictatorship, my grandfather six times, and exiled a number of times," Papandreou says. "He was almost executed basically fighting for democracy. So, you know, this has been part of the tradition."

In 1967, when he was a teenager, Papandreou was threatened at gunpoint when the Greek army seized power and came to the family house looking for his father, Andreas. Papandreou's maternal grandfather, a tough World War I veteran from Chicago, refused to let them in, Papandreou says.

"There were these guys with guns, and he said, 'Get out of here,'" Papandreou recalls. "And he closed the door on them, as a good soldier would. So they broke the door down."

George, armed with a shotgun, raced with his father up to the veranda on the roof. Realizing they were surrounded, he cached the weapon, and his father hid. Then one soldier came through the veranda door and held a machine gun to 14-year-old George's throat, asking the whereabouts of the father.

The senior Papandreou emerged from hiding and surrendered. He was beaten with guns and rifle butts, recalls Papandreou's brother, Nick, 53, a former World Bank economist turned writer who lives in Athens. "That was the moment that turned George from an extrovert to an introvert," Nick says. "It took George a long time to get over the trauma. He was more quiet after that. He seemed to think of the world differently."

Firepower reemerged, this time metaphorically, when Papandreou hectored the EU to provide support for Greece. He called in March for a "gun on the table"—meaning tangible measures from the EU—to halt bond speculators who were pushing up the country's borrowing costs. On Apr. 23 he used a televised address to call for the activation of a financial lifeline of as much as €45 billion, an unprecedented test of the euro's stability and European political cohesion.

Speaking from the remote island of Kastellorizo, population 430, Papandreou called on Greeks to make it a national priority to turn around the country. Standing before a bright blue sea, he evoked Odysseus, who battled monsters and vindictive gods to return to his island of Ithaca. Greece, he said, was "on a new odyssey."

Tough talk and rhetorical flourishes only count for so much. More than half of Greeks surveyed in June say they believe the country could go bankrupt, according to a poll by MRB for Mega TV.

"It's a moment where people looked at the edge of the cliff and said, 'You know, something's wrong here.'"

"There's a saying that politicians are made by events," says Stefanos Manos, a former Economy Minister. "The events have forced Papandreou's hand, to do things I am dead certain he would never have done on his own."

A Different Path to Power

Before being elected Prime Minister in 2009, Papandreou ran twice and lost. In a 2007 trouncing at the hands of Kostas Karamanlis, another scion of a political dynasty, Papandreou scored the lowest vote total for his party in a quarter century of Greek elections, and then had to fend off an internal challenge for party leadership. His eventual victory last year brought the Panhellenic Socialist Movement, or PASOK (the party his father, Andreas, founded in 1974) back to power after five years in opposition. "This guy is very resilient, and people tend to underestimate him," Finance Minister George Papaconstantinou, says. "In 2004 when we lost the election and in 2007 when we lost again, very few people were betting on him becoming Prime Minister."

For much of his life, Papandreou was preoccupied not with ruling Greece so much as merely returning to live there. Born in St. Paul, where his father was an economics professor at the University of Minnesota, George Papandreou lived in the U.S., Canada, Sweden, and Greece for much of his early life, attending eight schools in four countries over 12 years. Politics was always a part of his life; in Minnesota, he says his father campaigned for civil rights pioneer Hubert Humphrey.

During his years at Amherst College in Massachusetts, George would hang out with friends after dinner drinking a little ouzo and talking about Watergate and the Vietnam War, according to dorm mate Henry Boom, now director of the tuberculosis research unit at Case Western Reserve University in Cleveland. The two bonded over their shared experience of having an American mother and foreign father, says Boom, whose father is Dutch. He still talks to Papandreou several times a year.

With a father who earned a PhD in economics from Harvard University, Papandreou chose to study sociology. Compared with economics, he says, it "brings a little less hubris, let's say, about what you can do and what you can't do." He

PREVIOUS PAGE: NIKOS PILOS; OPPOSITE PAGE: COURTESY OF PAPANDREOU FAMILY

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Three generations of the Papandreou political dynasty

earned degrees from Amherst, Stockholm University, and a master's degree from the London School of Economics. "I think it was also a normal reaction, you know, I might do something different," Papandreou says. "Although in the end, I followed politics."

Papandreou's time in Sweden attuned him to northern European ideas of social dialogue and consensus that shaped his management style and political philosophy. "He's one of these people who actually believes in the process of dialogue," says Papaconstantinou. "Not just as a means to an end, but that it's an educational process, which sometimes is very tiring."

In Sweden, and then in Canada, Papandreou also got a firsthand look at functioning, if costly, welfare states. "I think vilifying the welfare system—and that's one thing I would say here in the U.S.—as the culprit for sovereign debt is wrong," Papandreou says. "There are countries that are very competitive with very strong welfare systems, the Nordic countries or Canada, Australia, just to give a few. They don't have generally the problem of sovereign debt."

Two of the Nordic countries Papandreou lauds do pay the highest taxes among 30 of the member countries of the Organization for Economic Cooperation & Development. Total tax revenue in Sweden accounts for an estimated 47.1 percent of economic output, while Denmark's is 48.3 percent, according to the OECD; in the U.S., it's 26.9 percent and in Greece, 31.3 percent.

First elected to Greece's Parliament in 1981, at age 29, George agreed to run only after his brother convinced him he had a real chance to change the country. Papandreou served in the education and culture posts under his father and as junior foreign minister. In 1999 he was promoted to Foreign Minister after his predecessor was forced to resign over a botched attempt to harbor Abdullah Ocalan, the Kurdish rebel leader that Turkey blamed for the deaths of more than 30,000 people.

As Foreign Minister, Papandreou turned around relations with Turkey. He built close personal ties with his Turkish counterpart, Ismail Cem, and when an earthquake struck Turkey in 1999, Papandreou was quick to send rescue teams. When an earthquake struck Greece three weeks later, Turkey reciprocated.

As a result of his upbringing, Papandreou is fluent in English and Swedish—and is occasionally ridiculed at home for lapses in Greek grammar. On May 6, when he was again derided for clumsy speech during a debate over the European rescue package for Greece, Papandreou fired back: "I am a Greek of the diaspora not because I chose it but because my father found himself exiled twice." It was a rare outburst for a man who friends describe as calm and cool. "He is always soft-spoken, pensive, has a gift for listening to others," says Richard Parker, an economist at Harvard University's Kennedy School of Government who talks with Papandreou several times a week as an informal adviser.

As a product of the 1960s, Papandreou has affinity for certain hippie values that also invite mockery from members of the press. "He seems to believe that no man is evil, every man is good, provided you help him to see the good," says Stefanos Kassimatis, a political columnist at the Greek daily newspaper *Kathimerini*. "'Love will find a way.' Spare us, please."

Papandreou's winning campaign last year seemed to take its cue from U.S. politics. "Roll up our sleeves" was a motif of his campaign, while one of his slogans was "Together, we can," an obvious nod to Barack Obama's "Yes we can." "I can see why people compare the two, the quiet determination and substance they have is very comparable," says Kemal Dervis, a Minister for Economic Affairs for Turkey when Papandreou was Greece's Foreign Minister.

The question today is whether all aspects of the man put him in a position to make good on his commitment in Vienna. Papandreou agrees with those who say this crisis will define his country. "It's a moment where people looked at the edge of the cliff and said, 'You know, something's wrong here,'" he says.

At the end of Papandreou's speech in Vienna, Dimitris Paraskevas, an Athens lawyer, stood up and said the vast majority of people in the audience didn't believe Greece would pay its debt. Before responding, Papandreou scanned the frescoed ceiling, looking, he later said, for baby Hercules wrestling snakes. Then he answered calmly. "We will honor our contracts with the financial community," he said, "and yes, we will pay our debt." —*With Simon Clark*

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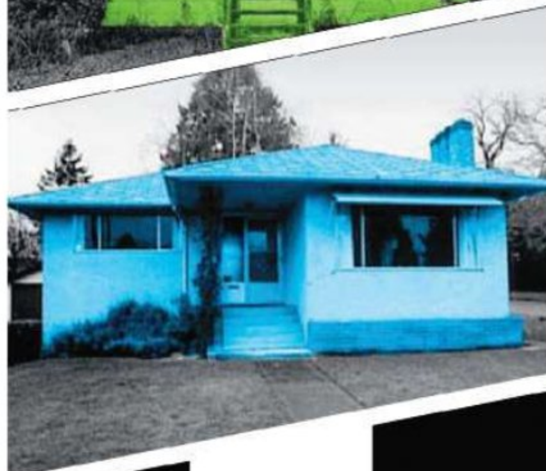
$1,077,000
Marpole
Size 2,775 sq.ft.
Bedrooms 3
Baths 2





$1,098,000
West Vancouver
Size 2,000 sq.ft.
Bedrooms 3
Baths 2

$1,090,000
Point Grey
Size: 2,000 sq.ft.
Bedrooms: 2
Baths: 1



Bub

In Vancouver, real estate agents think they're rock stars, cabbies are flipping condos, and shacks are going for $1 million*. So much for sensible Canada

By Bryant Urstadt



$1,150,000
Cambie
Size 2,150 sq.ft.
Bedrooms 3
Baths 2



*Prices shown are in Canadian dollars

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$1,099,000

Cambie
Size 1,844 sq.ft.
Bedrooms 3
Baths 2

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OR NOT?



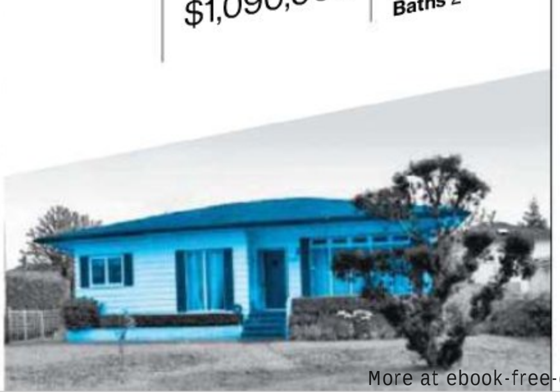
$1,249,000

Arbutus
Size 2,100 sq.ft.
Bedrooms 4
Baths 2



$1,090,000

Marpole
Size 2,400 sq.ft.
Bedrooms 3
Baths 2



The Olympics are over, and the Village is for sale. The complex in Vancouver, British Columbia, that housed the athletes during the 2010 Winter Olympics has been converted into 1,100 luxury condos. About 450 have been pre-sold, and the sales of the remainder may well render a verdict on a mystery that looms over this city like Grouse Mountain: Did Canada prudently steer its way clear of the worst of the financial crisis only to be rewarded with a massive housing bubble of its own?

On a bright, warm Saturday in late June, couples and families wandered through the empty village, which has been renamed Millenium Water. It opened for public tours last month and draws about 100 people a day. Millenium Water is a city of the future, built with enviro-touches like green roofs and automatic shades that moderate the temperature inside the apartments. An 815-square-foot, one-bedroom apartment is on sale for C$879,000, which works out to C$1,078 per square foot, or $12 higher than the average price in Manhattan, according to *The Corcoran Report*. (A Canadian dollar is currently worth about U.S. 96¢.)

Millenium Water isn't in downtown Manhattan, of course. It's not even in downtown Vancouver, which is across an inlet known as False Creek. It isn't really even in a neighborhood; the nearest establishment is the sales office for another condo development. If all this is starting to sound a little

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$11,980,000

Delta
Size 8,316 sq.ft.
Bedrooms 5
Baths 6 & 2 halfs



$5,195,000

Gleneagles
Size 5,900 sq.ft.
Bedrooms 5
Baths 5





$8,900,000

Point Grey
Size 6,355 sq.ft.
Bedrooms 7
Baths 8



irrationally exuberant, especially given the shaky international outlook, well, that's Vancouver for you.

"Real estate is like a sport here," says Tracie McTavish, president of Rennie Marketing Systems, which is overseeing the sale of Millenium Water. In the last 12 months alone, the average home price has risen 14%, to around C$1 million. One can look at charts to understand how long and intense the climb in prices has been, with inflation-adjusted prices of an average home in Vancouver doubling in the last 35 years, but it is much more fun to watch *The Vancouver Real Estate Market Roller Coaster*, a video posted by the anonymous owner of the website Vancouver Condo Info. Using software called NoLimits, the programmer turned that graph of inflation-adjusted home prices into a high-definition roller-coaster ride. Starting with a warning, "Please fasten your safety belt. Keep arms and assets inside ride at all times," the years float by like mileposts during the ride: 1979, 1980, a long climb up to 1981, and then a harrowing drop down to 1983. But it is the ride up from 2000 to 2010 that is the steepest, and that, except for a brief drop in 2008, seems to go on forever.

The video ends with an imagined plunge into the ocean.

To a visitor, it can seem as if Vancouver's main industry is real estate, like it used to seem in Las Vegas or Orange County. A newcomer, emerging from the gate for international arrivals, is greeted with three separate backlit billboards, all offering architects' renderings of planned communities. Aspac Developments promises that they're "building a legacy of excellence." Concord Pacific describes each of its multiple developments as "a master planned world unto itself with park, schools, daycares, shops, restaurants, and resort-style amenities." Polygon calls itself "Vancouver's Builder of Choice," and offers contact information in English and Chinese. Driving out of the airport and up Vancouver's main thoroughfare, Granville Street, one notices billboards for brokers and advertisements on the backs of buses for Realtors and developments.

"Some of the brokers in Vancouver think they're rock stars," says Grant Connell, a broker with Sotheby's. According to Connell, they are getting paid like them, too. "Many have made $500,000 or $1 million this year," he says. Connell, a former professional tennis player who spent years on tour, is among Sotheby's top-producing brokers. As of June of this year, he had amassed 52 "ends," as he calls a completed sale.

The market in Vancouver wasn't entirely unscathed by the financial crisis. Like the rest of the world, it took a hit. But prices rebounded, and the average home in the city is now about 10 percent above the pre-crash peak. On a driving tour, winding up a twisted knot of roads in the West Vancouver neighborhood, which stretches up a slope with a view of the bay and the mountains, Connell slows down by two similar homes. "I sold the first for $4 million right when it came on," he says. "The second was a little later to market. It took a long time to sell for $3 million. There's your 25 percent 2008 correction right there."

As Canada headed into 2009, Canadians jumped back into buying homes. Home prices in Canada have been strong from coast to coast, especially relative to the U.S. Vancouver prices, however, have run with special gusto.

In the second half of 2009, says Connell, "it was just spastic." He points to a narrow lot right on the beach, a vacant slot between two nice homes. "That was a $5.2 million sale last year," he says. "They tore down the home but never built anything."

In Vancouver, new developments are pre-sold via "assignment letters," or commitments to buy. Throughout 2009, say Connell and others, assignment letters were being flipped. "The minute I actually heard a taxi driver talking about flipping assignments," says Connell, "I knew something had to give."

Canada was supposed to have been safe from flippers, teardowns, bidding wars, and the other markers of the bubble that covered the States. Its banking system was voted the soundest by the World Economic Forum's most recent *Global Competitiveness Report*, and even President Obama has praised the country for being "a pretty good manager of the financial system and the economy in ways that we haven't always been." The mortgage default rate in Canada is less than half a percent, compared to 3.73 percent in the U.S., and its first quarter 2010 gross domestic product growth was a robust 6.1 percent. Reflecting its strength, Canada has been among the first of the developed nations to raise interest rates, pushing them up a quarter of a point on June 1, officially declaring its recession over.

"It could be that investors see Canada entering a renaissance," says David Rosenberg, chief economist at Toronto-based portfolio manager Gluskin Sheff. "As the old saying goes, in the land of the blind, the one-eyed man is King." Or as James Grant, editor of *Grant's Interest Rate Observer*, put it in a recent newsletter: "Such nice people, the Canadians–and solvent, too."

Canada's banking system is healthy in part because it went through a reform after a crisis in the early '90s. Though Canadian banks are among the largest in the world, and appear similar to the big American ones, they are much more tightly regulated–in ways that keep loan quality high and increase banks'

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$10,998,000
West Bay
Size 5,423 sq.ft.
Bedrooms 5
Baths 7

$10,998,000
Olde Caulfeild
Size 7,700 sq.ft.
Bedrooms 5
Baths 6

incentives to hold those loans. Terms are largely dictated by the Bank of Canada; borrowers putting less than 20 percent down, for example, are required to purchase insurance from providers like Genworth or the Canadian Mortgage & Housing Corporation. Unlike in the U.S., the big Canadian banks write the majority of those loans. Lastly, the majority of Canadian loans are recourse, meaning that lenders can go after a borrower's earnings and assets; walking away is a very unattractive option. All this has made Canadian home loans sound and banks stable.

All that safety and stability has come with a price. It may have overinflated prices. At least that's how some doubters see it. One Vancouver wag has actually been affixing "certified bubble pricing" stickers to Realtors' signs. Also among the skeptics is Petr Pospisil, a teacher in Vancouver who created a website called "Crack Shack or Mansion," in which the visitor attempts to guess whether a pictured bungalow is a bombed-out home of little value or a real Vancouver listing with a price of over a million Canadian dollars. Pospisil, alternately concerned and amused by what he saw as an irrational mania for real estate, got 30,000 views on the first day he put up the site. Within five days, 200,000 had played the game.

"Canadians defend their bubbles, especially here in Vancouver," says Pospisil. "People get angry when you tell them it's a bubble. They say it's different here, that this is such a beautiful place and everything is different. Everywhere there is a bubble, they say it's different."

Professionals like Robert Hogue, a senior economist at RBC Royal Bank, use less exciting language but fundamentally agree. "The type of price increases that we've seen in Vancouver are unlikely to be sustained," says Hogue. "There might be some downside risk to that market."

Some, like Garth Turner, a financial writer and former member of Parliament, see Canada going all the way down the road the U.S. took. "My basic view," he says, "is that we have a Canadian version of the U.S. real estate bubble. Not exactly the same, but close enough. We've relaxed lending standards, we have high unemployment, and we've reached a point of unsustainability in the housing market. I see real estate values falling shockingly."

Rosenberg notes three factors that have spurred home sales in recent months. First, as in the U.S., near-zero interest rates have kept mortgage prices at historic lows, sustaining demand for housing. Until June 1, the overnight rate target set by the Bank of Canada was one-quarter of a percent. It is now half a percent and expected to rise. Second, the Canadian Mortgage & Housing Corporation, Canada's hybrid version of the Housing & Urban Development Dept. and Fannie Mae, announced in February that in April it would be moderately tightening its standards for loans, decreasing the maximum length of loans from 40 months to 35 and increasing minimum down payments for certain types of loans. Third, a sales tax on services in Ontario and British Columbia goes into effect on July 1. The imminence of all three together has likely pushed some buyers to jump into the market, especially in Ontario and B.C.

Cameron Muir, chief economist for the British Columbia Real Estate Assn., argues for Vancouver's special situation, as do many in the trade. "Vancouver has had the highest prices in Canada for some time," says Muir. "The geography is constrained. You've got the Pacific on the West, the mountains to the north, the U.S. border to the south, and land reserves to the east. That puts tremendous upward pressure on land prices. We also have solid population growth with a sizeable proportion of immigrants." Vancouver is a city of just over 2 million, and Muir expects 40,000 immigrants this year. On top of that, says Muir, there are "high-net-worth Asian purchasers buying as investments, as second homes, or for satellite families."

Mainland China buyers are a fixture in conversations about Vancouver real estate, though reliable data on their numbers is elusive. "I'd say over half our high-end listings go to China buyers," says Connell. "Yesterday we did an open house for a $3.5 million home, and six groups came through. They were all Chinese."

Broker Andrew Hasman sees 70 to 80 percent of his high-end listings go to mainland Chinese. He oversaw an open house recently for a $1.8 million home. Of 100 visitors, 91 were from China. Spend enough time speaking with Rosenberg, Hasman, Muir, and others, and prices in Canada seem to make a kind of sense, a rational response to market forces that just so happens to have pushed prices way above the norm.

Like many brokers, Connell acknowledges that things are overheated. "I see it more stalling than anything. Units are starting to sit," he says, opening the door to a $3.8 million four-bedroom penthouse in Vancouver's downtown, in the seven-year-old Classico building. Decks on two sides look out over the tankers moored in English Bay, and Grouse Mountain beyond. It is a second home, full of stainless steel, granite, and floor-to-ceiling windows. At $1,688 a square foot, it is well over Manhattan's average. "This would have been snapped up just a couple of weeks ago," says Connell. But he's not overly concerned. "Everybody always has a take on Vancouver," he adds, "and nobody ever seems to be right." B

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Lakewood BlueClaws
Home



Boise Hawks
Home



Boise Hawks
Concept



Clearwater Threshers
Concept

It's Not Whether You Win or Lose. It's How You Sell The Game

Plan B. Branding helps turn minor league baseball into a lucrative, lovable freak show
By Paul Wachter



Spokane Indians
Home



Syracuse Chiefs
Home



Mahoning Valley Scrappers
Home



Swing of the Quad Cities
Defunct



Richmond Flying Squirrels
Home



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Concept


Syracuse Chiefs
Concept


Myrtle Beach Pelicans
Home


Myrtle Beach Pelicans
Alternate

From behind home plate, Jason Klein and Casey White look proudly at the Reading Phillies' flamethrower Phillippe Aumont. It's not his high-priced arm they're admiring, it's what he's wearing. "They're the only team with pink on their uniforms," White says.

Klein and White, who are each 30 years old, are the owners of Plan B. Branding, an upstart consulting company that has helped more than 30 minor league teams, including the Double-A Reading Phillies, rebrand themselves, creating new uniforms, logos, and in some cases even names. It's a thriving business, largely because minor league teams, unlike some in the majors, haven't suffered much in the recession. Attending a Reading Phillies game costs about as much as seeing a movie. "I won't say we're recession-proof, but we're recession-resistant," says Minor League Baseball President Pat O'Conner.

Merchandise sales account for about $50 million of MiLB's $750 million in annual revenue, but the true value is higher. "The merchandise drives awareness, which translates into ticket sales," says Ken Schnacke, presi-


Mobile BayBears
Home


Great Lakes Loons
Alternate


West Virginia Power
Alternate


Clearwater Threshers
Home

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dent of the Columbus Clippers and chair of MiLB's licensing committee. On average, 13 of MiLB's 160 teams rebrand themselves each year. Often it happens because a team moves, gets a new stadium or a new owner, or becomes affiliated with a different major league team. It also happens because a new look drives sales. "It's like if LeBron James changes his number," O'Conner says. "Everyone wants to buy the new jersey."

Perhaps the main reason you see more cosmetic changes in the minors is because the owners and their staff are, in essence, theatrical producers—and costumes are a big part of the show. "We don't control a single thing that happens on the field, not the players that are sent to us or the coaches," says Reading Phillies General Manager Scott Hunsicker. "What we control is what happens off the field and making it a great experience for the fans."

That's where Plan B comes in. The two owners, best friends since kindergarten, got off to an inauspicious start in baseball. They were fired from summer jobs with their hometown San Diego Padres after pulling a stunt in the stands involving a piñata of an opposing player stuffed with fake money. In 2002, while White attended New York's Pratt School of Art & Design and Klein the University of Alabama, aided by a mascot scholarship, they sent letters to every minor league team offering their design services. Only the West Tennessee Diamond Jaxx wrote back. For the Jaxx, now a Seattle Mariners Double-A affiliate, Klein and White designed the team's new logo, "Jim Dandy," a Disneyfied version of a miner wielding a baseball bat modified into a pickax. Merchandise sales spiked, word spread, and other clubs came calling.



THE ONE THAT GOT AWAY

In Bowling Green, Ky., fans chose the name Hot Rods over Plan B's favorite, the Cave Shrimp.

Two years later they completely reinvented the Clearwater Phillies. Like many minor-league teams, particularly those in the lower rungs, the Phillies were named after their parent club, which had nothing in the way of local identification. To come up with something that had greater resonance, White and Klein spent time on the Florida docks, where fishermen recounted their harrowing brushes with vicious sharks that use their tails to attack. They were called threshers, and soon enough, so was the team. With a logo cooked up by Plan B, the Clearwater Threshers sold eight times more gear in 2004 than in 2003.

By comparison, the rebranding of the Reading Phillies was a more modest affair. Team owners considered their association with Philadelphia to be an important asset, so the range of possibilities was more circumscribed. "We created a candy version of the Philadelphia Phillies uniform," Klein says. In place of the Liberty Bell, which the Philadelphia team uses on its patches, Plan B substituted a pagoda, alluding to a quirky Reading landmark.

Klein and White take pride in the time they spend with an organization and the research they do into local history before embarking on design work. "It's typically about a four-month process," Klein says. The fees start at $10,000 for a team and run as high as $80,000. After their research, they return to the studio and make dozens of pencil sketches of logos and get feedback from the team. "Next we work on colors," Klein says. "If it's a brick-heavy city, maybe we look at reds." Or if the team is on the coast, they're aware that "Pacific Ocean blues are different than Gulf Coast blues." Finally, they turn to uniforms. "We've developed a special in-house program that spits out every cap, jersey, and pant option known to man," Klein says.

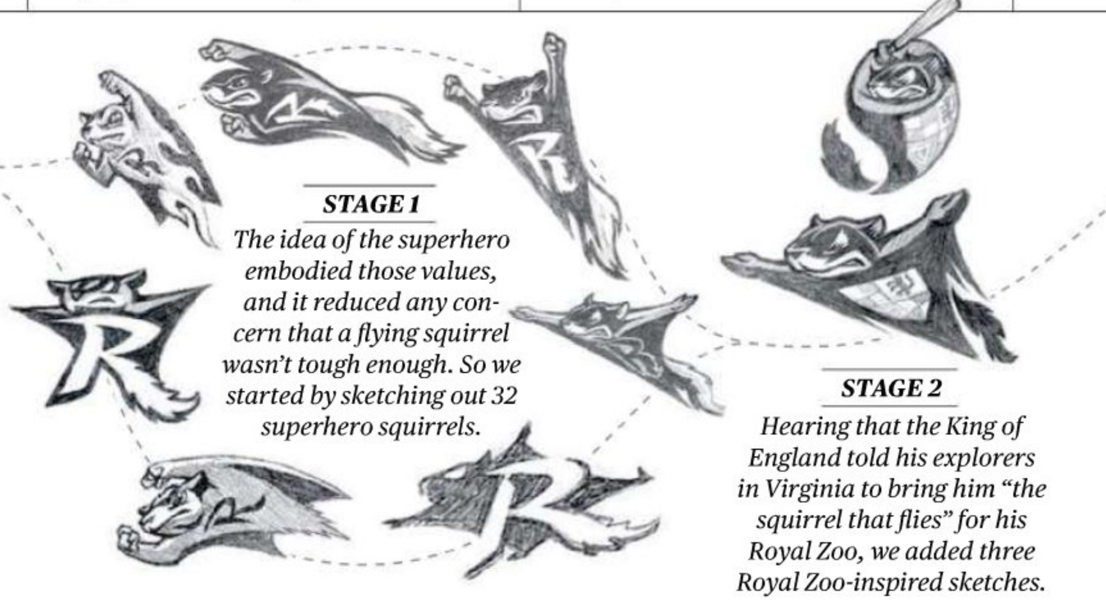
When possible, Plan B injects an element of zaniness into minor league teams. They're not paid to play it safe. Tasked with finding a name for a new team in Pennsylvania's Lehigh Valley, they proposed the IronPigs, a nod to the region's history of steel production. (Pig iron is the industry name for the raw iron ore that's melted down to make steel; it's melted into molds that resemble a row of piglets). The mascot's name is Ferrous, which refers to the chemical name for iron. In 2008, IronPigs merchandise was the league's best seller.

"Sometimes you get these crazy names, and you say there's no way it's going to work, but then they turn out to be real popular," says MiLB President O'Conner. Some compromise is necessary. Two years ago in Bowling Green, Ky., the Tampa Bay Rays Singe-A affiliate brought Plan B in to help overhaul their apparel but also held a name-the-team contest. Plan B threw its support behind the suggestion Cave Shrimp, a local creature that is blind, translucent, and does, in fact, live in caves. The name made the



The Evolution of the Flying Squirrel

In 2009 the Connecticut Defenders relocated to Richmond, Va., and were renamed the Flying Squirrels after a 6,000-entry name-the-team contest. Two themes ran through many submissions: symbols of power (generals, monuments) and rebellion (renegades, rebels). Plan B walks through the design process:



STAGE 1

The idea of the superhero embodied those values, and it reduced any concern that a flying squirrel wasn't tough enough. So we started by sketching out 32 superhero squirrels.

STAGE 2

Hearing that the King of England told his explorers in Virginia to bring him "the squirrel that flies" for his Royal Zoo, we added three Royal Zoo-inspired sketches.

OPENING SPREAD: PHOTOGRAPHS BY DAVIES+STARR FOR BLOOMBERG BUSINESSWEEK. THIS SPREAD: PHOTOGRAPH BY GREGG SEGAL FOR BLOOMBERG BUSINESSWEEK; SQUIRREL: JOE MCDONALD/CORBIS

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Jason Klein (left) and Casey White of Plan B are the leading sluggers of minor league branding

final list of seven, though fans ultimately chose Hot Rods.

Sometimes an imaginative concept draws an initial negative response then sinks in over time, as happened with the Richmond Flying Squirrels. Klein credits the team owner for effectively selling the concept by appearing at the official unveiling of the logo dressed in a squirrel superhero costume and taking questions mainly from members of a fourth-grade class who were in attendance.

Despite Plan B's success, minor league teams generally don't turn to outside talent for their logos. "Consultants are a bad word in our industry," says Hunsicker, who is wearing shorts and a funky collared shirt on game night. "But Jason and Casey don't come off like consultants. They do this Jedi mind trick where you think their ideas are your own. And they spend time with everyone, empowering the lowest guys on our staff. That alone is something worth paying for."

Successful minor league teams pull out all the stops in entertaining their fans. Beyond the right field fence at Reading's FirstEnergy Stadium, in lieu of bleachers, is a swimming pool where kids splash about under their parents' watchful eyes. On this night, a carrot mascot beat out other vegetables in a dash to a finish line near third base. And the postgame fireworks received a bigger ovation than a three-run homer in the ninth inning by Reading's top prospect.

One of Plan B's core concepts is "Shout your story"–so why have one mascot when you can have a whole rock band made of mascots (as the Reading Phillies do)? Plan B also promotes different aspects of the "ballpark experience." For Reading, they helped develop the label "Deck Heads" for the rambunctious, beer-swilling fans who populate the left field stands, and the team sells a shirt targeted to them. They also suggested that the team adopt the hipper team moniker current in the local vernacular, the R-Phils, another name that can be sold.

"Fifteen years ago, a minor league team had a home jersey and road jersey," says Chuck Domino, the former president of the Reading Phillies, who now runs the Richmond Flying Squirrels and the Lehigh Valley IronPigs. "Now, teams also have Sunday uniforms and batting practice uniforms, and they're all for sale."

As Plan B grows, Klein and White have begun working with teams outside the minors. They tweaked Mr. Redlegs, the brand character who appears on the sleeve emblem of the Cincinnati Reds and have consulted for several WNBA and Arena Football League teams as well as the clothier for USA Gymnastics. They also run a website called the Clink Room, where amateur designers dream up their own teams and logos and compete to get them made into caps and T-shirts.

While they say they would welcome a call from the Steinbrenner family, Plan B's owners insist they'll always feel more at home in the minor leagues. "In the minors, you can come up with an idea, and the team can run with it in 48 hours," White says. "That's not how it works with the Cincinnati Reds."

After the game, Klein and White join Hunsicker and other Reading Phillies' employees for beers in the RBI Room, a no-frills private hangout in the bowels of the stadium. No players drop by, nor is there much talk about the actual sport of baseball. There is, however, much drinking, and Klein and White only leave at 5 in the morning so they won't miss their flight back West. There are lots of sayings in the minors, and Klein shares another one, an oblique reference to the hard-living world they've come to love: "If you're gonna hoot with the owls, you better be able to soar with the eagles." B



STAGE 3

The staff loved the squirrel and the R-tail, so that's the direction we headed in. We scrapped the coat-of-arms concepts because it would be difficult to embroider. The next step was digitizing the Flying Squirrel sketch. We tried an Old English "R" chest emblem. With a head too big and arms too short, we refined him.

STAGE 4

Then Chuck Domino thought we should ditch the comic-book eyes for something a little more beady and realistic. We tossed in the idea of an acorn logo.





FINAL LOGO

We readjusted the squirrel's proportions and applied the R-tail emblem. After looking at several color stories, red, gray, and black won out. Embodying Virginia's fighting spirit, the logo ushered in the 2010 inaugural season.

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Where the Copy Machine Never Jams...



...because there is no copy machine. How some people are managing to work from the beach. Seriously. *By Joel Stein*

Photograph by Misha Gravenor

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Etc. The Workplace

While you're Dilberting away in your cubicle, there are people taking conference calls in board shorts and flip-flops. While you're saving your two weeks of vacation to hit the sand, they're getting paid to be there. There are people—even respectable people—who have somehow turned a folding chair into a place of work.

Aided by technology, pioneers are now converting the beach into a fully functional office. People who work from the beach in non-hotel, non-burger-stand, non-pot-dealer capacities are still rare enough that no agency tracks the phenomenon. Brooks Brothers does not yet make a three-piece bathing suit; Herman Miller doesn't sell an Aeron chaise.

It's not like these beach workers are slackers; they just don't like being controlled. It's the same reason why we TiVo shows or e-mail and text more than call. When you can work from wherever you want to be—especially if it's the place where everyone wants to be—work isn't so bad.

It helps to be self-employed. And to do something that's already weird. Like Eric Poses. The 36-year-old owns a one-man company called All Things Equal that makes board games such as the hit Loaded Questions franchise. He has an office five blocks from the ocean in Miami Beach and takes a legal pad and a beach chair there about once a week for three hours. In the summer his family moves to Santa Monica, Calif., where he puts in a hard three hours of beach work per day. It's a relatively austere environment considering that, in his late 20s, he developed a game while downing beers at a W Hotel.

At the beach, Poses tries not to use his BlackBerry. He doesn't go in the ocean much, but when he does he just leaves his phone and pad on his chair. ("I've been lucky so far," he says.) Poses has become so used to focusing from the sand that he doesn't get distracted by the bikini wearers he shares his office with. "During the week it's not quite as crowded."

"Money fills me with anxiety," says publicist Valerie Michaels. "I make my CFO meet me on the beach"

Ward Holloway has a job that is so serious it's boring to even explain. He's director of "global check point alliance" for Crossbeam Systems; he manages a partnership between his company in Dallas and one in Israel that provides security for corporate networks and involves something called a Godbox. (Told you.) And while he does a ton of traveling, for two months each year he works in a beach chair under an umbrella on a lake in Macatawa, Mich.

Holloway uses his BlackBerry and his laptop, which gets wireless from his in-laws' nearby house, thanks to a booster he installed. If it's not windy, he says his laptop doesn't get too sandy, though once a week he has to take the back off his BlackBerry, remove the battery, and blow out all the sand. "If the waves are especially large, you have to have strategic control over the mute button on a conference call," Holloway says. There are a few other people who work on his beach. And, just like in any other office, they like to get together to bitch. "We commiserate. Like, 'Wouldn't it be great if we didn't have our BlackBerries with us all the time and we could just relax?' "

Bill Kilburg, 48, is the chairman and chief executive of Scottsdale (Ariz.)-based Hospitality Performance Network Global, a broker of group meetings. For six weeks each summer, he and his co-founder rent houses five blocks apart in Mission Beach, San Diego, and work from there. "My CFO gets my parking space, so she's happy," Kilburg says. He generally works from the shore on his BlackBerry until 1 p.m., then cracks a beer and heads into the ocean.

PHOTOGRAPH BY MISHA GRAVENOR FOR BLOOMBERG BUSINESSWEEK



Michaels says no one has ever complained about her work style

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He's philosophical about his ability to lead the 170-person company from the beach. "My job is the strategic growth of the company," he says. "It's not like I have to be sitting in my office to do that."

Alan Laubsch is one of the founding members of risk-management firm RiskMetrics Group, which broke off from JPMorgan in 1998, where he had worked since graduating from Stanford in 1993. For more than half the week, Laubsch works from his condo in Hua Hin, a beachside village two hours from Bangkok where the King of Thailand also has a summer place. While Laubsch tries not to do too much work from the beach, he does take conference calls. "People are complaining that since the advent of e-mail and cell phones, we're tied to technology," he says. "That's the shadow side of technology, that it can enslave you. But it can liberate you to work from where you want to work."

The most liberated of all the regular beach workers may be Valerie Michaels, who owns City Publicity, which handles extreme-sports stars. She has three employees and an office on Sunset Boulevard in Los Angeles, but she prefers working on the beach in Malibu. "Thinking about money fills me with anxiety, so I make my CFO meet me on the beach," she says.

Michaels, a tanned 35-year-old who wears giant sunglasses and talks superfast, heads alone to the beach most days, bringing her Burton cooler with built-in iPod speakers. She packs it with coconut water or chlorophyll drinks (on Fridays, it's Coors Light), tuna on a baguette, Kettle Chips, two sunblock lotions, a hair tie, Post-It notes, and a pen. She pays $600 a year for access to the Las Costa Beach Club, which provides the only stretch of non-homeowner-controlled beach in the area, plus bathrooms, chairs, a fridge, picnic tables, and a cooking area. She picks up a chair and places it next to the lifeguard stand—"They're all hot, it's great eye candy!"—puts her BlackBerry in one of the cup holders, and strips down to her bikini. "I live in a bikini. I have a drawer this deep filled with bikinis," she says while making the universal symbol for a deep drawer.

"If the waves are especially large, you have to have strategic control over the mute button," says one beach worker

Not long ago, after posting a Facebook photo of her feet buried in sand, Michaels got a text from a client that read, "Hard at work, I see." She says no one has ever seriously complained about her work style. "Obviously you can't make cars this way," she says. "But it's publicity. We're not curing cancer." That morning, she met with 16-year-old snowboarder Trevor Jacob, who showed her a video of him jumping into a pool from a motel balcony. He's not the kind of client who will gripe that Michaels isn't at a desk in a pantsuit.

For Michaels, the beach is now a better office than an actual office, because it mirrors—sort of—the low-tech, pre-Internet version of working at a desk. As she throws a tennis ball for two chocolate labs that run up to her, she says: "I'm less distracted on the beach than I am at the computer. My BlackBerry has a slow connection to the Web, but I don't need it. I'd be on my Google start page or looking at my horoscope." That advantage may not last. As of June, Las Costa began delivering Wi-Fi right on the beach. The club expects more businesspeople to join her.

When Michaels has to take serious calls, she says most people don't notice the surf in the background. "If it's real windy out here, I just say I'm driving," she says. Though her business is doing well, her lifestyle does impose some limitations. "I've been offered the in-house position at UFC [Ultimate Fighting Championship], but no way. I'm not moving to Vegas," she says. "There's no beach there." B



Shore up Your Office

Simple steps for adding sea-loving style to your cubicle



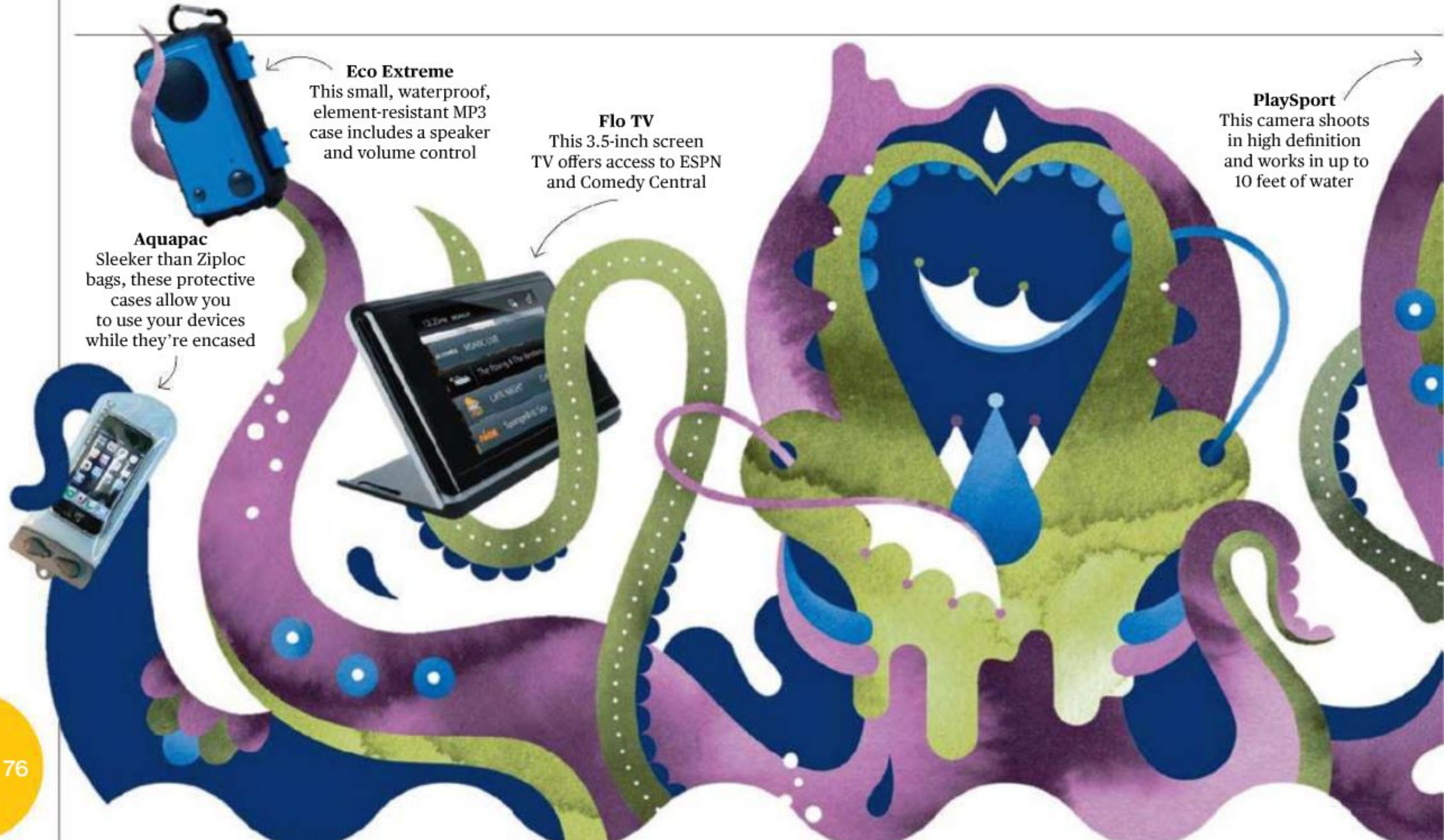
The Nearly Natural Silk Sea Grass Plant
Soft silk sea grasses fill this modular desk-size planter. ($55 at kohls.com)

The Fish Pen
Try writing with a pen that resembles a longer, svelter Nemo. ($15 at pylones-usa.com)

The Tea Sub
Fill this submarine-shaped tea infuser with loose leaves and steep in hot water. ($14 at fredflare.com)

The Weathered Wood Table Lamp
The Atlantic driftwood base adds a nautical look to your desktop. ($179 at westelm.com)

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Tune In to Tune Out

The essential gadgets guide for bringing the best of the living room to the beach. *By Rich Jaroslovsky*

Tempting as it may be to fantasize about leaving your digital life behind when you hit the beach, the option may not be feasible, or even really desirable. Although the era of accessibility makes complete escape harder, it makes partial escape easier—and more enjoyable. Here are a passel of products that might prove useful next to the suntan lotion and cooler.

▶ Computer

While Panasonic makes military-specification computers meant for use in some of the world's most inhospitable locales, its F8 and F9 Toughbooks belong to a class of machines known as "business rugged," meaning they may survive having a cup of beer dumped on them, although not necessarily a full pitcher.

The magnesium-alloy case, with a built-in handle, encloses a 14.1-inch antiglare screen, and the whole package weighs only a little more than 3½ pounds. The F9, which goes on sale this month, starts at $2,899 and includes Windows 7, an Intel Core i5 processor, and 320-gigabyte hard drive; the older F8, with a less powerful Core 2 processor and 250-gigabyte hard drive, lists for $2,499.

Since no one buys a computer simply for a few hours of sun, consider these landlocked benefits, too. A shock-mounted hard drive means the F8 and F9 can survive being dropped a foot onto a hard surface, and an optional Gobi chip provides mobile broadband wherever in the world you happen to be.

▶ TV

If you're worried about missing live World Cup action—or, admit it, a critical rerun of *Jersey Shore*—Qualcomm's Flo TV personal television will keep you properly tuned in. The $199.99 unit has a 3.5-inch screen and comes with a one-year subscription to the Flo TV service, which includes programming from ABC, CBS, NBC, and Fox. A package of additional networks—including ESPN, Comedy Central, and Disney—costs another $149.99. You can watch Flo TV for up to six hours in between charges.

Qualcomm also makes Flo TV available as a service on phones from Samsung, LG, and other manufacturers on both the AT&T and Verizon networks. The advantage of the standalone unit is that you won't deplete your phone battery. Make sure, though, that your particular beach is

ILLUSTRATION BY JANINE REWELL

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The Toughbook This laptop can survive a cup of beer or a fall from your canvas bag

Kindle On account of its grayscale display, Kindle is the best e-reader for the beach

within the Flo network. Coverage can be spottier at some Hamptons than others.

▶ E-Reader

The e-book not only relieves vacationers of having to lug hardcovers wherever they go, it also provides cover for them to indulge in their darker habits. (Chelsea Handler readers, you know who you are.) Apple's iPad is the all-around best, but its glaring weakness is, well, glare. The backlit display and reflective screen make it hard to use in direct sunlight, even if you weren't concerned about getting sand in the virtual gears of your $829 3G-enabled baby.

By contrast, Amazon.com's $189 Kindle thrives outside. Its grayscale digital-ink display is easily readable even in direct sunlight; it weighs a mere 10 ounces and goes for days on a single charge. Best of all, its built-in AT&T 3G connection lets you buy and download books anywhere you happen to be. Additionally, Amazon's family of free Kindle apps syncs your reading material across devices, so you can pick up on your iPad precisely where you left off on the Kindle.

▶ Cameras

Kodak recently added the $149.95 PlaySport to its line of handheld digital video recorders. The PlaySport is small—4½ ounces, less than an inch thick—but it shoots big: full high-definition video at 30 frames per second. You can use it in depths of up to 10 feet of water. And if you find the controls a little hard to maneuver under the waves, the built-in image stabilization may help smooth things out. The PlaySport is also capable of taking still photos, with a sensor rated at five megapixels.

If you need more power, Panasonic's $399.99 Lumix DMC-TS2 puts some of the Toughbook's DNA into a compact, 14.1-megapixel point-and-shoot camera that's waterproof at depths up to 33 feet.

▶ Music

Grace Digital Audio's $49.99 Eco Extreme is an element-resistant, waterproof case that holds your portable music player or iPhone, combined with a three-inch speaker that provides decent sound without earning you dirty looks from the next blanket over. The Eco Extreme, which plugs into the headphone jack of your music player, runs on three AA batteries and has an external volume-control knob.

▶ Protection

While the classic waterproof protector for your cell phone may be the Ziploc bag, its cost-effectiveness is undermined by certain disadvantages—such as the inoperability of the phone while it's in the bag.

Aquapac (www.aquapac.net) sells a variety of cases for iPhones, Kindles, and other mobile devices that allows you to continue to use them while they remain protected. Some of the cases even keep your gadget afloat, giving you a chance to rescue your BlackBerry before it drifts out to sea. Ⓑ

The Pursuit of Appyness

Enhance the beach experience, and even your tan, via your iPhone with these apps. —*Arik Hesseldahl*



Beach Buddy, 99¢

Why wait until you've made the trip to find out the water's cold? This app provides water temperature, wave heights, and rip current warnings.



Sun Alert, $1.99

When you enter your skin type, sunscreen SPF, and location, Sun Alert figures out how much exposure is safe—before you figure it out the hard way.



Tide Clock, 99¢

Plan your trip according to the tide. This app checks a beach's high and low tide—and even the moon phase.



Weber's On the Grill, $4.99

Barbecue king Weber's app is a mini-encyclopedia of grilling basics and expert tips, plus recipes for sauces and rubs.



Beach Finder, 99¢

Check a database of 5,300 beaches in North America from your phone. A separate app searches British beaches.



Weather Radar, $2.99

Are those clouds headed your way or passing by? This app gives you a live radar image from the National Weather Service covering your location.



Beach Safety, free

Between rip currents and jellyfish, beaches can prove dangerous. This app tells you how to avoid one and how to treat stings caused by the other.



Safe Seafood, 99¢

Given the presence of contaminants like mercury in fish, this app is particularly useful in picking seafood that is both healthy and environmentally sustainable.



Ships Ahoy! 99¢

Want to know which oligarch owns the superyacht that just sailed by? Take a picture with your phone's camera to find its name, size, and speed.



Surf Watch, $9.99

This app tracks data from floating buoys around the world and can notify you when the surf is up at your favorite spot.

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Riding a Wave Out of M&A

Keeling picked up surfing when doing business in Los Angeles for Sullivan & Cromwell

Hans Keeling left law firm Sullivan & Cromwell to plan surfing trips in Brazil

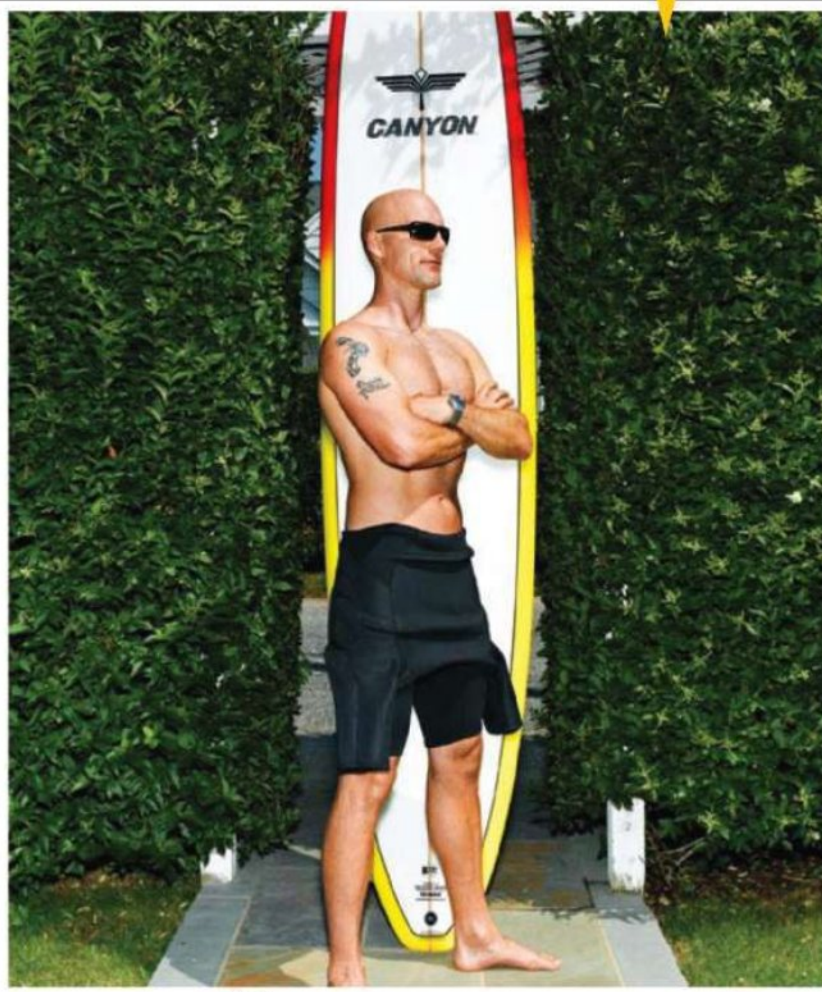
The trail that leads from the Ivy League through law school to white-shoe firm Sullivan & Cromwell rarely ends at a remote Brazilian beach. Yet it did for Hans Keeling after just three years of working on mergers and acquisitions for the New York City law firm. A 2004 trip to Brazil convinced Keeling he would rather advise clients on their vacations than on their capital markets transactions.

Weeks after the trip, Keeling, now 34, moved to Brazil. "He came back having had an epiphany that this wasn't what he wanted to do with his life," says Chris Kerezsi, a former Sullivan & Cromwell colleague who worked on a deal with Keeling until midnight right before he left for Rio. "People were shocked."

Keeling hoped to enjoy a laid-back Brazilian lifestyle and still work as a lawyer. So he joined the Rio law office of Pinheiro Neto Advogados. "Brazil didn't have the high-powered careers," he says. "Everyone was living in the moment." When Keeling's parents visited, though, work left him little time to be with them. Weighing his options, Keeling remembered a trip he'd taken to the Brazilian island of Florianopolis, with its 42 pristine beaches, Europhile culture, and vibrant nightlife. The relatively remote location struck him as an excellent destination to open a business. That fall he relocated there and launched a travel and adventure company, Nexus Surf.

The business plan called for arranging trips, including lodging, nightlife guides, and sports instruction such as surfing lessons. Running a small business was a struggle at first. "Being at a huge law firm is like steering the *Titanic*," he says. "You don't want to sink it. When you're an entrepreneur, it's like driving a motorboat; you have to be more agile and dynamic."

While Keeling lost money on his first clients, he soon partnered with sports outfitters and began to turn a profit. In 2006 his company began investing in vacation home rentals. He is currently planning an oceanfront hotel on a 65-acre plot that he owns. "The scariest part was leaving the track," he says, "and thinking that doors close when the corporate ladder goes away." Instead, former colleagues are visiting—and, Keeling says, finding it painful to leave. —*Alexandra Wolfe*



The signature local drink: *caipirinha de morango* (a strawberry *caipirinha*)



FROM ENDLESS MEETINGS TO THE ENDLESS SUMMER

- **Hours per week at Sullivan & Cromwell:** 80
- **Hours per week at Nexus Surf:** 40
- **Startup costs:** $50,000
- **Months it took to launch Nexus Surf:** 4
- **Average number of clients per year:** 300
- **Number of world-class surf breaks in Florianopolis:** 12
- **Favorite local surf spot:** Praia Mole Beach
- **Average cost for a weeklong stay in Florianopolis:** $3,000
- **Average price for a 4-bedroom beach house on the island:** $750,000
- **Number of tourists who visit each year:** 1 million-plus
- **Cost of building a 75-suite oceanfront boutique hotel in Florianopolis:** Approximately $20 million

DATA: NEXUS SURF

TOP: PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK; BOTTOM: FOOD COLLECTION/GETTY IMAGES

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Etc. One True Thing

The Beach Chair

French-based Quel Objet uses Basque beechwood and French cotton, woven in the Pyrénées, to make its deck chairs

A comfortable classic perfect for a day at the shore

The Want: A reclining, portable chair that looks stylish in the sand. Nothing too low or too high and definitely no scratchy polyester strips or sticky vinyl. It should be adjustable for napping, reading, and even making notes on an iPad.

The Get: Quel Objet's Borce Deck Chair ($140 at quelobjet.com), with a light yet sturdy frame, reclines to four positions and folds to fit in a car trunk. The durable fabric can be removed easily for cleaning, thanks to detachable triangular-shaped rods at either end.
—Chloe Lieske



CHAIR: PHOTOGRAPH BY TOM SCHIERLITZ FOR BLOOMBERG BUSINESSWEEK

BLOCK PARTY

A sun-protection crib sheet



Lotion: Neutrogena Ultra Sheer Dry-Touch Sunblock SPF 30. Dries to a powdery finish that won't stick to sand. $9



Face Lotion: Ocean Potion Suncare Clear Zinc Oxide Face Potion, SPF 45. Lifeguard-level protection in a clear formula. $4



Wipe: Supergoop! SPF 30 Sunscreen Swipes with Zinc for Sensitive Skin. Won't spill in your beach bag. $34 for 40 wipes



Spray: Mission Skincare All-Sport SPF 30+ Continuous Spray. Pro athletes favor this fast-drying, sweat-proof shield. $10

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Afternoon Escapes

Get from the office to one of these hidden beaches in two hours or less. *By Ondine Cohane*



Wear sturdy shoes for a hike down the 150 foot bluff to El Matador Beach

Los Angeles: El Matador

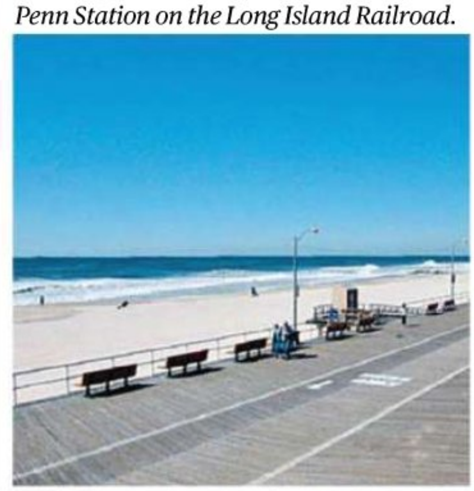
Travel time: **45 min. (from Century City)**

Malibu's most beautiful—and isolated—pocket of sand sits beneath moss-covered cliffs west of L.A. in the Robert Meyer Memorial State Beach. Sea caves, eroded sandstone pillars, and clear water draw weekend crowds, though it's easy to find your own space midweek. After a few hours in the sun, cool off in the echoey marble galleries of the nearby **Getty Villa**, a museum inspired by the ancient Roman Villa of the Papyri, which was buried in volcanic ash until the mid-18th century. *How to go: Take the Pacific Coast Highway west to El Matador. Park on the roadside or pay $4 for a spot in the parking lot.*

New York: Long Beach

Travel time: **1 hr. (from Midtown)**

This boardwalk-fronted beach town is in vogue, thanks to its proximity to Manhattan (a mere 25 miles away), the new **Allegria** boutique hotel, and, of course, its five-mile sandy stretch. Surf the breaks and stroll the boardwalk before hitting the free concerts staged three times a week in the summer (see longbeachny.org for info). Try the Allegria for dinner (get the striped sea bass with chili-lime beurre blanc), and you might extend your trip overnight: You'll wake up to waves crashing outside one of the hotel's neutral-toned rooms ($300 or so on weeknights). *How to go: It's an hour from Penn Station on the Long Island Railroad.*

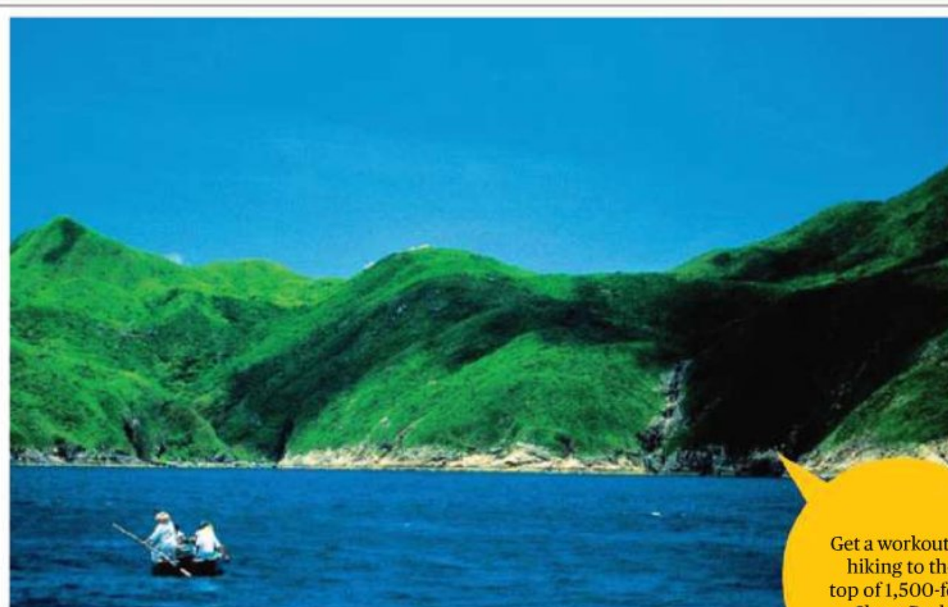


Hong Kong: Tai Long Wan

Travel time: **1.5 hrs. (from Central Hong Kong)**

A quick boat ride from the city's skyscrapers, this pristine bay on the Sai Kung Peninsula has somehow evaded development: Most afternoons, its white-sand beaches are only inhabited by sea birds and a handful of day-trippers. Arrive in the morning and kayak, snorkel, or swim in transparent waters until it's time to dig into a grilled seafood skewer from one of the barbecues set up seaside. Come sundown, board the **Jaspas Party Junk** boat returning to neon-lit Hong Kong. *How to go: The boat makes the journey in an hour for $77 per person, including food and drinks.*





Get a workout by hiking to the top of 1,500-foot Sharp Peak

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Panther Beach's most remote section, Hole in the Wall, was once known for topless tanning

San Francisco: Panther Beach

Travel time: **1.5 hrs. (from Financial District)**





Unmarked and worth the steep hike from the road, this hidden section of shore is 10 miles north of surfer-dude Santa Cruz. A lucky few know its hidden caves, urchin-filled tide pools, sea lions, and stunning golden rock formations. By day, rock climb to 25-foot heights; at night, expect to see a bonfire. Pick up picnic supplies beforehand at San Francisco's locavore **Bi-Rite Market** and grab an ice cream cone for the road from the creamery next door. *How to go: Drive south on Highway 1. Stop between mile markers 26.86 and 26.4. A small path crosses the railroad tracks from the west side of the highway.*



Chicago: Forest Park Beach

Travel time: **1 hr. (from the Loop)**

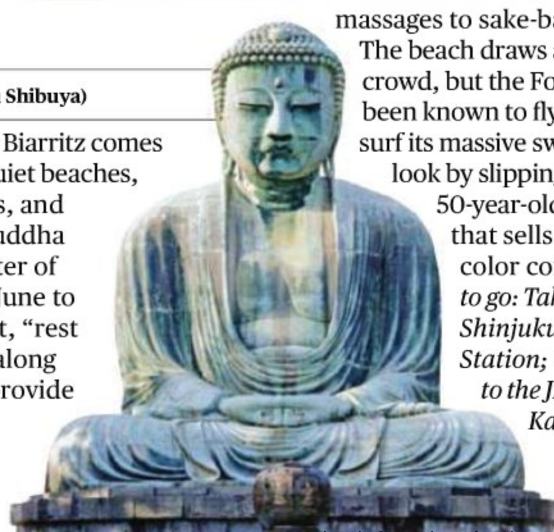
When the Michigan Avenue masses leave you yearning for a green stretch of lakeside, travel an hour north to this 29-acre park. Its large swathes of sand are divided by outcroppings of rock that make for great swimming. There's also a fishing pier, shaded hiking trails, and a cart lending beachy books from the Lake Forest Public Library. Visit the **Grille on Laurel** for an Old Fashioned or a classic Reuben sandwich before heading back downtown. *How to go: From Water Tower Place take I-94 W to the Deerpath/Lake Forest College exit. There's a $10 admission on weekends, but weekdays are free.*



Tokyo: Kamakura

Travel time: **1 hr. (from Shibuya)**

Japan's answer to Biarritz comes with great surf, quiet beaches, beautiful temples, and a giant bronze Buddha statue in the center of town. From late June to the end of August, "rest houses" pop up along the sea front to provide everything from massages to sake-based cocktails. The beach draws a mostly Japanese crowd, but the Foo Fighters have been known to fly in from Seattle to surf its massive swells. Get the local look by slipping into **Genbei**, a 50-year-old flip-flop shop that sells its wares in 100 color combinations. *How to go: Take the JR Shonan Shinjuku Line to Totsuka Station; then transfer to the JR Yokosuka Line to Kamakura Station.*



London: Whitstable

Travel time: **1.5 hrs. (from The City)**



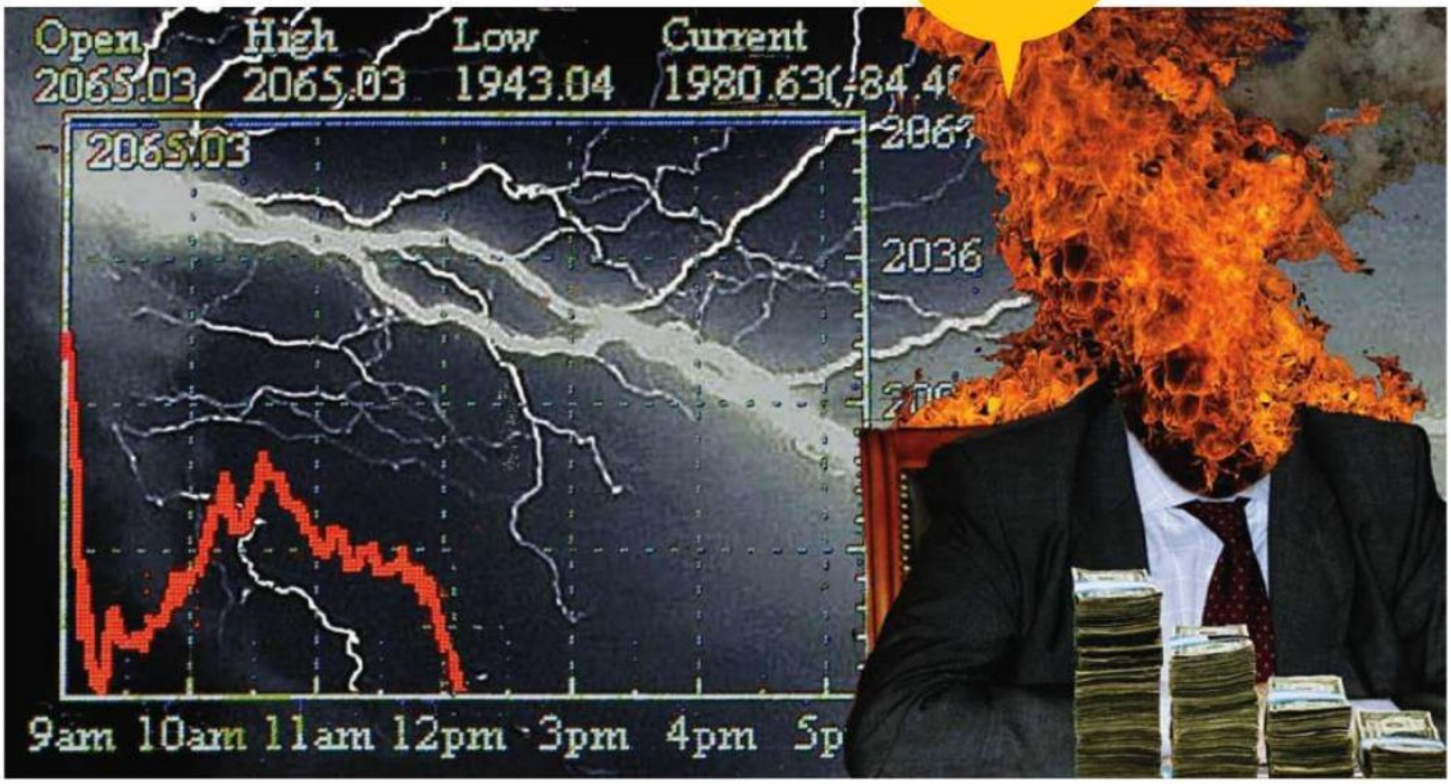
A former fishing village, Whitstable attracts in-the-know Londoners seeking pretty pebble beaches, top-notch seafood, and a Ye Olde English vibe. Work up an appetite by swimming at West Beach (10 minutes east of the main drag), then do dinner at **Wheelers,** a pink-painted BYOB spot famous for excellent oysters. (Pop across the street to buy a bottle of wine from **Threshers Wine Shop.**) Locals love the town's top fish-and-chipper, **VC Jones**, which specializes in haddock and draws a queue every night. *How to go: Hop on the Ramsgate train from Victoria Station.*



EL MATADOR: MIKE SHAFFER; LONG BEACH: CITY OF LONG BEACH; TAI LONG WAN: HKTB; SEAGULL: ANIK MESSIER/GETTY IMAGES; PANTHER BEACH: JIM PATTERSON; FOREST PARK BEACH: CITY OF LAKE FOREST; ICE CREAM: COMSTOCK/GETTY IMAGES; KAMAKURA: SANKEI/GETTY IMAGES; OYSTERS: ISABELLE ROZENBAUM AND FREDERIC CIROU/GETTY IMAGES; WHITSTABLE: LEE THOMPSON/GETTY IMAGES; BUDDHA: GAVIN HELLIER/GETTY IMAGES

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The protagonist worried about the global financial system but did not feel responsible for it



Tales of a Hedge Fund Burnout

Through a series of interviews, a manager recounts the collapse in real time. *By Hugo Lindgren*

Let's say you've resolved to free yourself from the tyranny of Stieg Larsson by attempting something more productive with your beach reading this summer. Like, what the heck, dipping your toe into that vast ocean of financial crisis literature. So at the next barbecue you can be the guy amazing and delighting everyone with a witty elucidation of how the commercial paper market nearly seized up.

But which book? You've read the *Vanity Fair* excerpt of *The Big Short,* and *Too Big To Fail*, not yet in paperback, is, alas, too big to lug to the beach. Less taxing and more portable is *Diary of a Very Bad Year: Confessions of an Anonymous Hedge Fund Manager*. It's like the Cliff Notes of the financial crisis, which is a useful thing to have.

Be forewarned, however, that the title is misleading in at least three ways. First, this book is not a diary; it's a series of interviews conducted as the crisis unfolded by novelist Keith Gessen, who is also the editor of the literary magazine *n+1,* of an acquaintance who has worked at a hedge fund for a decade.

Second, the year that this anonymous hedge fund manager, referred to as HFM in the book, chronicles does not turn out to be very bad for him at all. In 2008, while millions of Americans were losing their jobs, homes, and life savings, all he lost was some peace of mind. His fund–which he describes in not-great detail as a market-neutral, long-short operation–suffered only minor financial losses.

Third, there's nothing remotely confessional in this book. Our hero reveals no bad deeds, or even much in the way of bad thoughts, and he accepts blame for absolutely nothing. Anonymous was just a dude doing his job, worried about the precarious state of the world financial system, yes, but not in any way responsible for it.

So let's call the book "Conversations about a Very Bad Year for Other People" and give it props as perfectly serviceable beach reading–and sometimes more than that. It does something few of the books written about the crisis have accomplished: It delivers an insider perspective on the events

i

Diary of a Very Bad Year: Confessions of an Anonymous Hedge Fund Manager

By Anonymous Hedge Fund Manager and Keith Gessen
HARPER PERENNIAL; 272 pp, $14.99

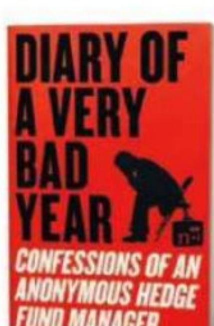


ILLUSTRATION BY KENNARDPHILLIPPS; MONEY, SUIT, LIGHTENING, CHART: GETTY IMAGES

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in real time, rather than dwelling on conclusions reached after the fact.

This hedge fund manager was not a brilliant seer who predicted the housing bubble would burst and positioned himself to bathe in the profits. Nor was he an imbecile who piled into the other side of John Paulson's trades, then later claimed to be victimized. He was, like most intelligent life on Wall Street, somewhere in between, cognizant of the risks inherent in the rampant securitization of debt but unsure of how exactly to exploit it while protecting his investors.

Initially he believed, as did many, that subprime excesses would not explode into a larger economic trauma. But he became increasingly distressed by how the real-estate boom distorted the American economy, sucking energy and talent into the superfluous production of houses and the financial superstructure that sat atop them.

Although skeptical of governmental intrusion into the markets, Anonymous supported many of the bailouts, including AIG's, as necessary emergency measures. He recognized the need for an aggressive stimulus package, though he worried that without proper vigilance it would result in permanent governmental bloat. These views are fairly conventional within the business community but are muted in many of the journalistic and academic accounts of the crisis. Here they are expressed forcefully, clearly, and persuasively.

If *Diary of a Very Bad Year* is appealing for the clarity of its big-picture elements, it is less so in its little pictures. Anonymous tries hard to sound like a regular fella but occasionally comes across as smug and self-absorbed. At one point, while describing his own material needs, he says that "personally, I have enough stuff–it's painful for me when I get a gift." Then, at the end of the book, we find out that this man who wants for nothing has decided to retire to Austin–in part because he's "getting killed on New York City taxes."

What now? After stumbling into a fabulously lucrative line of work that exists primarily in New York City, he'd prefer his wealth not support the schools, parks, hospitals, housing, and transit systems that the rest of the city relies on. Such casual disregard for civic responsibility makes us want to chuck this little book into the surf and go for a swim. B

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Ian Schrager

"In retrospect, it was ridiculous: I should have developed all of my hotels under one name. I'm in the hotel business, not the cool business"

The father of the boutique hotel reflects on deciding not to brand, working with Marriott, and stopping rivals from stealing his ideas



When I started Morgans Hotel in New York in 1984 there wasn't a sophisticated hotel that reflected my lifestyle. When I opened the Royalton just a few blocks away, people said I was crazy to put them so close together. But they were distinctive. I opened another hotel, The Paramount, which had small rooms; rather than disguising them, we made it feel like an ocean liner. Next came the Delano in Miami when South Beach was a tropical slum. Then I went to L.A. and London.

I agonized over whether to do my hotels under one brand. In business, a brand is something that people understand. But it felt cool not to have one, and I thought people would think I was selling out if I named the hotels after myself. I worried about losing what was special about each one, so I gave each its own name.

As I expanded, I realized that was a bad business decision. The properties have value, but a brand itself has a value too. In retrospect it was ridiculous: I should have developed all of my hotels under one name. I'm in the hotel business, not the cool business.

I'm now developing lines of high-end and lower-end hotels under distinctive brands. I'm working with Marriott to get scale for my ideas. Everything you see in hotels today–whether it's white beds or no patterned carpets–we did that. When somebody has a good idea, everybody runs to do it and they kill the good idea. The hotel business risks falling into the same trap it fell into 40 years ago. They all look alike.

This time, I want to ramp up quickly so all my ideas don't get taken again. W Hotels showed me how big the market could be. It's the same-sized market that buys Apple products, Nike sneakers, and Zara clothes. Consumers looking for a heightened hotel experience are not only in New York and Miami and LA. They're in Milwaukee; they're in cities around the world. And I'd like to think they know when something's the real thing. —*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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